Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

JOHN N. BAIN and JOHN G. GILFILLAN, III,

Petitioners,

v.

FREDERICK F. BUECHEL, M.D., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS, STATE OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

For five years, Respondents pursued a claim against Petitioners' former law partner seeking to terminate *ab initio*, as contrary to the public policy of New York as defined by its case law and attorney's code of ethics, the former partner's interest in two trusts arising from a contingent equity fee agreement expressly authorized for patent practitioners by federal law (37 C.F.R. § 10.64). On the eve of trial in that action, the trial court denied Respondents' last-minute motion to amend their pleading to bring the same claim against Petitioners. Respondents subsequently filed this action, and after obtaining a favorable judgment against Petitioners' former partner, persuaded the trial court to (a) exercise jurisdiction over Petitioners and (b) summarily bind Petitioners to the prior judgment without trial, notwithstanding the court's denial of Respondents' motion to bring a claim against Petitioners in the prior action.

I. Does 28 U.S.C. § 1338 and the Supremacy Clause preclude a state court from exercising jurisdiction over a civil action to rescind an equity fee agreement expressly authorized by federal patent law and preempt the application of conflicting state law to find the agreement invalid?

II. Did the New York Court of Appeals infringe Petitioners' procedural due process rights by binding them to a judgment in a prior action in which they were expressly relieved of liability by court order?

PARTIES TO THE PROCEEDINGS BELOW

The parties before the New York Court of Appeals were Petitioners John N. Bain and John G. Gilfillan, III, who are the defendants in a suit brought by Respondents Frederick F. Buechel and Michael J. Pappas. The law firm of Carella, Byrne, Bain, Gilfillan, Cecchi, Stewart & Olstein was named as a defendant, and R. Gale Rhodes, Jr. and Paul A. Witte were named as defendant-beneficiaries of a certain trust entitled Biomedical Engineering Trust in the suit below, but they were not parties to the appeal below to the New York Court of Appeals.

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John N. Bain and John G. Gilfillan, III respectfully petition for a writ of certiorari to review a decision of the Court of Appeals of the State of New York (the "Court of Appeals").

OPINIONS BELOW

The decision of the Court of Appeals is reported at 2001 WL 1636938 (N.Y. Dec. 20, 2001). The decision of the New York Appellate Division, First Department is reported at 275 A.D.2d 65, 713 N.Y.S.2d 332 (N.Y. App. Div. 2000). The decisions of the New York Supreme Court, New York County are unreported. Copies of all decisions are in the Appendix.

STATEMENT OF JURISDICTION

The Court of Appeals entered its decision on December 20, 2001. This Court has jurisdiction under 28 U.S.C. § 1257(a).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The issues in this case implicate the Supremacy Clause, the Fourteenth Amendment of the United States Constitution, 28 U.S.C. § 1338 and 37 C.F.R. § 10.64. Excerpts of these provisions are set forth at App. 154a-155a.

STATEMENT OF THE CASE

This case concerns the validity of a set of fee arrangements by which Petitioners, two New Jersey patent lawyers, received a proprietary interest in certain patents as the fee for prosecuting those patents on behalf of Respondents, two New Jersey inventors. Accepting equity in those patents in lieu of a cash fee is expressly permitted, and indeed encouraged, by the code of professional responsibility issued by the United States Patent and Trademark Office (the "PTO Code"), which regulates the practice of patent law. *See* 37 C.F.R. § 10.20, *et seq*. Far from recognizing the supremacy of federal regulation of patent practitioners' equity fees, the New York courts ruled that these two New Jersey patent lawyers are subject to New York's Code of Professional Responsibility (the "New York Code"), imposing far-reaching burdens on the acceptance of equity fees found nowhere in the PTO Code. Indeed, the New York courts not only improperly applied New York law to an area preempted by

federal regulations, but they had no subject matter jurisdiction to consider the validity of these equity fee agreements in the first place. That question is the subject of exclusive federal jurisdiction under 28 U.S.C. § 1338(a).

Compounding their jurisdictional and preemption errors, the New York courts never gave Petitioners any opportunity to defend their fee agreements in any forum. Rather, the New York courts applied preclusion principles offensively to estop Petitioners from mounting any defense whatsoever to the claims asserted against them. The courts below ruled that Petitioners are bound to a decision issued, not against them, but against a different person, at a prior trial, notwithstanding the prior court's express ruling that Respondents could not assert such claims against Petitioners in that action. The New York court's radical extension of the doctrine of offensive collateral estoppel to preclude Petitioners from defending themselves is a manifest due process violation.

A. Procedural History

(1) The Prior Action

In 1987, Petitioners' former law partner, R. Gale Rhodes, Jr., commenced an action in New York Supreme Court against Respondents as trustees of two trusts ("Trust I" and "Trust II," respectively), the corpuses of which were patents covering prosthetic devices Respondents had invented (the "*Rhodes* action"). App. 3a. Rhodes' complaint pertained exclusively to Respondents' alleged misconduct as trustees of Trust I. App. 3a, 44a-45a. Rhodes charged that Respondents had unlawfully diverted trust income for their own personal interests and sought an accounting and to remove them as trustees. App. 3a, 44a-45a. In addition to acting as trustees, Respondents each held a one-third beneficiary interest in both trusts. App. 2a-3a. Petitioners and Rhodes each held a one-ninth beneficiary interest in Trust I. App. 2a.[1]

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1. Rhodes, but not Petitioners, was also a beneficiary of Trust II. App. 2a-3a.

Pursuant to New York procedural rules, Rhodes joined Petitioners as "defendant-beneficiaries" in the *Rhodes* action in response to Respondents' motion to dismiss for failure to join a necessary party. App. 19a, 50a-51a. Petitioners, however, did not participate in that lawsuit, and Rhodes never asserted claims for relief against them. App. 3a, 19a, 45a.

Some four years after Rhodes initiated suit, Respondents, as individuals and not as trustees, interposed five counterclaims solely against Rhodes. App. 3a, 19a. Their third counterclaim – which is the only counterclaim on which they were awarded judgment – sought rescission *ab initio* of only *Rhodes'* interest in Trust I, on the ground that by taking an equity interest in the patents held in trust Rhodes had violated New York law pertaining to attorney ethics. App. 3a, 19a, 97a, 98a, 152a. Respondents specifically excluded any effort to rescind Petitioners' interest.

Four years later (or nearly eight years after the *Rhodes* action commenced), Petitioners questioned certain of Respondents' conduct as trustees. Respondents retaliated by firing them as counsel. Then, on the eve of trial in the *Rhodes* action, Respondents moved to amend their counter-complaint to assert claims for the first time against Petitioners. App. 4a, 19a. The *Rhodes* court denied Respondents' belated motion, concluding that adding Petitioners as counterclaim-defendants on the eve of trial would have resulted in undue prejudice either to Rhodes (if trial was delayed to allow Petitioners to take discovery) or to Petitioners (if they were denied discovery). App. 73a. Although permitted an interlocutory appeal under New York law, Respondents elected not to appeal or even to move to vacate or reconsider that order. Instead, on March 21, 1995, before the *Rhodes* trial had begun, Respondents brought this separate action against Petitioners, which was stayed while Rhodes' suit proceeded to trial. App. 5a, 20a.

After a bench trial in which Petitioners did not participate, the trial court issued a judgment in favor of Respondents on their third counterclaim for rescission of Rhodes' interest in the

trusts. App. 120-121a.[2] The judgment was based exclusively on state law. Rhodes failed even to raise the defense that 37 C.F.R. § 10.64 governed or that federal jurisdiction was exclusive.

B. The Instant Action And The New York State Court Decisions

Following the decision in the *Rhodes* action, Respondents moved for summary judgment below, asking the trial court (and the same judge) to bind Petitioners to its prior decision in the *Rhodes* action and to terminate Petitioners' interest in Trust I. App. 56a, *et seq*. In response, Petitioners argued, *inter alia*, that to bar them from an opportunity to litigate the claims against them on the merits would infringe their due process rights as they were expressly excused from liability in the *Rhodes* action; in addition, Petitioners cross-moved for summary judgment on or about September 18, 1998. App. 56a, *et seq*. By memorandum decision dated May 26, 1999, the trial court held that Petitioners were bound by the *Rhodes* judgment under the doctrine of collateral estoppel by finding them in privity with Rhodes, notwithstanding that they had not been partners since 1981. The trial court thus terminated Petitioners' interest in the patents, and ruled that Petitioners had to repay all monies paid to them since 1974 (less a yet-to-be determined amount in *quantum meruit*). App. 64a-70a.[3]

Shortly thereafter, Respondents served an amended complaint. App. 61a. In lieu of answering, Petitioners moved to dismiss on the ground that this dispute over the validity of the

2. That judgment was affirmed by the New York Supreme Court Appellate Division. *Rhodes v. Buechel*, 685 N.Y.S.2d 65 (N.Y. App. Div. 1999). The New York Court of Appeals declined review.

3. Two issues remain before the trial court: (i) the calculation of the *quantum meruit* value of the legal services rendered by Petitioners; and (ii) a state law malpractice claim. This Court has jurisdiction under 28 U.S.C. § 1257 because the "the federal [jurisdictional and due process] issue[s], finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings." *Cox Broad. Corp. v. Cohn*, 420 U.S. 469, 479 (1975); *accord Radio Station WOW, Inc. v. Johnson*, 326 U.S. 120 (1945).

fee agreement arose under federal patent law, and therefore this action falls under exclusive federal jurisdiction pursuant to 28 U.S.C. § 1338. App. 60a, *et seq.*

On January 11, 2000, the trial court issued an order denying Petitioners' motion to dismiss for lack of subject matter jurisdiction on the ground that "[t]he interpretation of the patent law on issues of patent priority and infringement are hardly at issue in this action." App. 61a. On January 19, 2000, the trial court issued a second order applying the holding of its May 26, 1999 memorandum decision to the amended complaint and voiding Petitioners' equity fee agreement. App. 56a-58a.

On September 28, 2000, the New York Appellate Division (First Department) affirmed the trial court's orders, but on different grounds. App. 40a-55a. First, the court asserted jurisdiction over this action and the equity fee arrangement on the ground that the fee arrangement, although sanctioned by federal law, violated the "Canons of Ethics governing the practice of law in [New York]." App. 53a-54a.[4] On the due process issue, it reasoned that, because Petitioners had been joined as beneficiaries of Trust I, they had an affirmative duty to inject themselves into the *Rhodes* litigation in their personal capacities even though no claims for relief were pending against them. App. 48a-51a. Thus, it affirmed on the basis of party-preclusion (*i.e.*, claim preclusion/*res judicata*) rather than on the privity-preclusion theory (*i.e.*, issue preclusion/collateral estoppel) that the trial court had cited.[5]

In a split decision, the New York Court of Appeals affirmed. App. 1a-39a. On the jurisdictional question, the Court of Appeals found that the New York courts properly

4. Petitioner, Bain is not a member of the Bar of New York and does not practice law in New York. The Trust was executed in New Jersey between New Jersey lawyers and their clients, both of whom were residents of New Jersey, and performed by Petitioners in New Jersey.

5. The court held alternatively that Petitioners were in privity with Rhodes because they had once been law partners (until 1981) and because they appeared to share a mutuality of interests. App. 51a-53a.

exercised jurisdiction because (i) Respondents "did not plead any substantive questions of patent law as an element of claims asserted against Petitioners"; (ii) "this cause does not sound in patent law because the interpretation of the patent laws on the issues of priority and infringement are hardly at issue"; and (iii) notwithstanding that "[f]ederal patent law recognizes that attorneys may receive an interest in patents in lieu of traditional fee arrangements," the validity of such non-traditional arrangements does not obviate the need for the disclosure mandated by the New York Code. App. 14a (internal quotation marks and citation to trial court decision omitted).

On the preclusion issue, the Court of Appeals affirmed on the basis of privity-preclusion. It based its privity finding largely upon its determination that Petitioners' "rights to receive payment [under the fee agreement] were coextensive with Rhodes and derived from the identical arrangement" and its perception that their "interests were aligned with Rhodes with respect to the lawfulness of the fee arrangement." App. 10a.

In dissent, Judge Levine protested that the majority's opinion "offends traditional notions of due process guaranteeing that parties must have their day in court before their rights are adjudicated." App. 36a. Judge Levine explained that due process does not permit a party to be bound to an adverse ruling against a prior party merely because their rights were "coextensive, derived from the same source and 'aligned,' *i.e.*, substantially identical." App. 34a. The dissent criticized the majority's rationale as nothing more than an expansive form of privity based upon a theory of virtual representation or aligned interests that has been

expressly rejected by this Court[6] and by several federal circuits,[7] and criticized by commentators.[8] App. 36a-37a.

REASONS FOR GRANTING THE WRIT

The New York state court's decision to exercise jurisdiction over the fees charged by patent practitioners, and to apply its own public policy under case law pertaining to New York's ethical standards to supplant the explicit federal policy in the federal code governing the conduct of patent practitioners, poses problems of federalism of enormous significance to inventors and patent lawyers throughout the country. This Court has had occasion in the past to review, and reject, state-sponsored restrictions on federally-licensed and federally-regulated patent practitioners. *See Sperry v. State of Fla. ex rel. Fla. Bar*, 373 U.S. 379, 384 (1963). In this case, the New York courts have announced that fee arrangements explicitly authorized by federal law – that is, fees payable in the form of an equity interest in patents, rather than in hourly charges – are so "disfavored," and so encumbered by restrictions, disclosure requirements and "independent counsel" requirements, and so "dubious" and "suspi[cious]," as to be essentially impossible to use. App. 98a-102a.

There are approximately 27,000 patent practitioners in this country. Under 37 C.F.R. § 10.64, those practitioners (and their clients) are allowed to take advantage of alternative fee arrangements that may be unusual (or entirely improper) under a given state's laws applicable to state-licensed attorneys. Federal law does not view such arrangements "with suspicion," and does

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6. *See Richards v. Jefferson County*, 517 U.S. 793 (1996).

7. *See, e.g., Becherer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 193 F.3d 415 (6th Cir. 1999) (en banc); *Tice v. American Airlines, Inc.*, 162 F.3d 966 (7th Cir. 1999).

8. *See, e.g.*, 18 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE § 4457; R. Jason Richards, *Richards v. Jefferson County: The Supreme Court Stems the Crimson Tide of Res Judicata*, 38 Santa Clara L. Rev. 691 (1998); Jack L. Johnson, *Due or Voodoo Process: Virtual Representation as a Justification for the Preclusion of a Nonparty's Claim*, 68 Tul. L. Rev. 1303 (1994).

not consider them "of dubious propriety." Quite the opposite: these fee arrangements serve the federal purpose of facilitating counsel for inventors who lack the resources to pay in cash.

The New York rule set forth in this case makes it dangerous business indeed to agree to a contingent equity fee. Reading the trial court's excoriation of such arrangements – which was affirmed throughout the proceedings below – would discourage any prudent practitioner from entering into any such agreement. Patent practitioners and their clients now run the risk of having equity fees expressly authorized and encouraged by federal regulations, declared void *ab initio* by any one of 50 state courts. This can happen, and did happen here, after years of faithful performance, imposing retroactive liability on patent practitioners for monies paid years in the past. Worse, the state-court-imposed *requirements* of (a) retention of "independent counsel" for the inventor to represent him about the fee, (b) highly detailed and speculative written disclosures and (c) strict and highly skeptical scrutiny of such arrangements if litigation ensues, combine not just to discourage such fees, but to undermine their essential federal purpose even if they were to be used.

Further, only by engrafting state law onto the permissive federal rules did the state court exercise subject matter jurisdiction in the first place. Yet jurisdiction over disputes implicating the interpretation or application of the patent laws rests exclusively with the federal courts. *See* 28 U.S.C. § 1338(a). Patent practitioner ethics, the fees they can charge and fee structures they can utilize are governed by federal patent law. *See* 37 C.F.R. 10.20, *et seq*. Moreover, 37 C.F.R. § 10.64, which permits the very contingent fee arrangement in issue, expresses federal public policy to provide cash-starved inventors seeking patent protection with an alternative non-cash arrangement to secure competent representation from a federally licensed patent practioner. Disputes about the ethical propriety of such arrangements, are certainly claims "arising under any Act of Congress relating to patents." 28 U.S.C. § 1338(a).

For these reasons, the opinion of the New York Court of Appeals directly conflicts with opinions of both this Court and the federal circuit courts which uniformly hold that:

- States are preempted from regulating the practice of federal patent practitioners. *See Sperry*, 373 U.S. at 384; *Silverman v. State Bar of Tex.*, 405 F.2d 410, 411 (5th Cir. 1968).
- Any claim that rests on, or will survive or be defeated by, the interpretation of federal patent law and the PTO Code is subject to exclusive federal jurisdiction. *See, e.g., Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808-09 (1988); *Helfgott & Karas, P.C. v. Dickerson*, 209 F.3d 1328, 1334 (Fed. Cir. 2000).

New York's assertion of jurisdiction over two New Jersey patent practitioners, its application of New York substantive law to their dispute with their clients and its effective abolition of contingent equity fees for inventors, plainly exceed the constitutional authority of any state court. Taken together, these holdings affect the daily professional lives of the entire federal patent bar, as well as the hundreds of thousands of individuals and companies who utilize their services.

The jurisdictional excesses of the state courts in this case have been compounded by their refusal to permit Petitioners even to present their case. Rather, Petitioners have been bound to a prior judgment rendered in an action involving their former law partner. This is so notwithstanding the fact that Petitioners *prevailed* in opposing a motion to amend to bring them into that prior action. This offensive use of preclusion doctrines has denied Petitioners their day in court even though, by receiving a court order entitling them *not* to appear in the prior action, an independent day in court was given an implicit but obvious judicial imprimatur. This separate day in court is exceedingly important here: Petitioners have available to them defenses not available to Rhodes, whose relationship with Respondents went

its own way during the *twenty years* since Rhodes ceased to be the partner of Petitioners.

Our research has revealed no case in which the party who prevailed in opposing a motion to amend a complaint has later been bound to the judgment in the case from which he was formally relieved of party status. Not in New York; not anywhere. The various holdings of the New York courts in this case on this subject – and they vary substantially from each other – have one thing in common: they all presume that despite prevailing on the motion to amend, Petitioners were obligated (on pain of having no hearing at all) to jump into the prior action anyway.

This is obviously an injustice.

One may argue, however, that this injustice is confined to its own unique facts and its own complex procedural history. Not so. In its ultimate formulation of the doctrinal basis for denying Petitioners their own day in court, the New York Court of Appeals has resuscitated a discredited view of the due process parameters of *res judicata* that permits litigation preclusion so long as the interests of the party to the second action are aligned with those of the party to the first action. Indeed, the Court of Appeals has adopted this view so strongly that it permits no exception for a party who was relieved of jeopardy in the first action by explicit court order.

It is this holding that poses grave constitutional dangers. It is this holding that is the main target of Justice Levine's 25-page dissent. And rightfully so. It has been clear for quite some time that due process prohibits a court from precluding a plaintiff from litigating his rights solely on the basis of an identity of interests with a prior litigant. *See Richards*, 517 U.S. at 799-805; *Becherer*, 193 F.3d at 424; *Tice*, 162 F.3d at 972. Rather, litigation preclusion principles have developed over time to assure that their anti-redundancy function is fulfilled within the due process imperative of assuring each independent party an independent right to present a case. The civil injustice done to Petitioners by precluding the presentation of their case will not be an isolated one under the New York standard.

This Court has spoken on each of these issues often in the past. We submit that the holdings below are sufficiently significant to warrant speaking once again.

I. The New York Court's Assumption Of Jurisdiction Over The Validity Of An Equity Fee Agreement Expressly Authorized By Federal Patent Law, And Its Imposition Of Conflicting Substantive State Law, Raise Major Legal Issues Affecting The Entire Federal Patent Bar

Congress has granted the federal courts original and exclusive jurisdiction over all claims "arising under any Act of Congress relating to patents." 28 U.S.C. § 1338. This Court has ruled that federal jurisdiction under Section 1338(a) extends to claims where (i) federal patent law creates the cause of action, or (ii) the plaintiff's right to relief necessarily depends upon a "substantial question of federal patent law," including where "some rights or interest will be defeated or sustained by a particular construction of federal patent law." *Christianson*, 486 U.S. at 808-09; *see also Helfgott & Karas*, 209 F.3d at 1334; *Franchi v. Manbeck*, 972 F.2d 1283, 1286 (Fed. Cir. 1992).

The validity of the fee agreement between Petitioners and Respondents, and therefore the proper disposition of Respondents' claim, can only be determined by reference to applicable federal patent regulations, 37 C.F.R. § 10.20, *et seq.*, which expressly authorize patent practitioners to accept an equity interest in a patent as part or all of their fee. *See id.* § 10.64.

Instead, the lower courts have imposed their own state law to encumber the federal standard to the point of eradicating it in practice. The trial court held in *Rhodes,* the decision to which Petitioners have been bound below, that contingent equity fees are so disfavored as a matter of New York law as to be virtually impossible to implement ethically. In contrast to the express authorization of such fees under 37 C.F.R. § 10.64 without encumbrances, and in derogation of the regulatory purpose that applauds such fees as encouraging representation of impecunious inventors, the trial court held:

- Equity fees are treated as a "transaction with a client" where there is always a real or latent "conflict of interest," and thus they are "presumptively void," of "dubious propriety," "regarded with suspicion," and generally "not advisable."
- Disclosure of potential conflicts of interest must be enormously detailed, and shall include notice of the "inherent" conflicts of interest, the "great potential for a lawsuit," loss of objectivity, the possibility of cash fee arrangements, the lawyer's profit motive, termination rights and more.
- Counsel must recommend that the client retain "independent counsel" to scrutinize the fee arrangements and "should insist" on the presence of "another lawyer."
- The burden of proving compliance with all of the foregoing is "squarely on the shoulders of the attorney."

App. 98a-102a. These holdings were applied in this case, and affirmed throughout. The New York courts have applied New York law to two New Jersey-based federal patent practitioners who represented New Jersey clients. This ruling poses a host of legal problems of national significance to the patent bar.

A. The Supremacy Clause Violation

The New York holdings conflict with federal law and public policy. By holding the equity fee agreement invalid under the New York Code, the Court of Appeals impermissibly circumscribed Petitioners' practice before the PTO and "impose[d] upon the performance of activity sanctioned by federal license additional conditions not contemplated by Congress." *Sperry*, 373 U.S. at 384.[9] The Supremacy Clause of

9. The goal of the patent system is to foster, reward and promote invention. *See Kewanee Oil Co. v. Bicron Corp.*, 416 U.S. 470, 480-81 (1974). This objective is sometimes hindered by the prohibitive cost of (Cont'd)

the United States Constitution, art. VI, cl. 2, prohibits such state intrusion on federal power. *See Sperry*, 373 U.S. at 384; *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372 (2000).

An "attorney engaged in patent practice is obviously, inescapably, and inseparably performing within a field committed by the Constitution to the regulation of the general government." *Silverman*, 405 F.2d at 414. It is a legitimate objective of patent law to encourage the taking of an equity interest in a patent in lieu of a cash fee to reduce the barriers to obtaining patent counsel. *See supra* note 9; 37 C.F.R. § 10.64. The holdings below destroy that possibility.

As formulated by the trial court, the New York rules eviscerate the federal rules for all practical purposes. Few patent practitioners will risk fee agreements "of dubious propriety" that will be viewed with "suspicion" in court. Few clients who want or need a non-cash fee structure will hire "independent counsel" to negotiate with their patent counsel. The disclosures required are at least daunting, if not outright impossible to implement. The holdings below violate the Supremacy Clause and conflict with precisely formulated permissive federal regulations. They also intrude on a general field occupied by federal law (the 55-paragraph ethics code embodied by 37 C.F.R. § 10.20, *et seq.*), and the specific field of patent practitioner fee structures and management (37 C.F.R. § 10.64). These issues affect the entirety of the federal patent bar on a daily basis, along with all of the clients of that bar. The effect of the New York rule "is to deny a privilege entitled to federal protection," *Silverman*, 405 F.2d at 414, and to "hinder or obstruct the free

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(Cont'd)
actually obtaining a patent. For the inventor who would otherwise be thwarted, Congress – through the PTO – promulgated a solution, *i.e.*, Section 10.64. *See* 49 Fed. Reg. 33, 790, 33,798 ("There are inventors who would not be able to apply for a patent and secure the assistance of a registered practitioner unless the practitioner may take an interest in the patent as part or all of his or her fee. The text of proposed § 10.64(a) is being changed to permit a practitioner to acquire an interest in a patent case.").

use of a license granted under an act of Congress." *Sperry*, 373 U.S. at 385. The conflict between New York and federal law on this issue could not be more stark.

Decisions of this Court and the federal circuit courts uniformly reject state efforts to circumscribe the practice of patent practitioners. For example, in *Sperry*, the State of Florida charged a patent attorney with the unauthorized practice of law because he practiced patent law in Florida without also obtaining a state law license. *See id.* at 381. This Court held that because Congress had authorized the Commissioner of Patents to prescribe regulations governing the conduct of attorneys practicing before the Patent Office, the Supremacy Clause prohibited Florida from enforcing state licensing requirements that would have given it a power to review and override the federal determination authorizing Sperry to practice patent law. *Id.* at 383-85.

Likewise, *Silverman* concerned a Texas-licensed attorney registered to practice before the PTO. The State of Texas contended that he was bound by the Texas ethics rules when advertising his patent law practice in Texas. 405 F.2d at 411. Relying on *Sperry*, the Fifth Circuit held that an attorney engaged in patent practice is performing within a field the Constitution has placed under exclusive federal control and further ruled that, when performing patent-related activities, Silverman was bound solely by the PTO Rules which preempted otherwise applicable Texas rules. *Id.*

The plain rule flowing from these decisions is that state law and state courts may not circumscribe federally authorized patent lawyers from practicing patent law within their borders, including limiting the right to accept equity fees authorized by 37 C.F.R § 10.64. When Petitioners entered into an equity fee agreement with Respondents to provide services before the PTO, Petitioners were obligated to comply with the PTO Code only – and not the New York Code – in structuring that agreement.

The Court of Appeals never acknowledged, let alone addressed, *Sperry* or *Silverman*. Yet, the preemption in this case could not be more clear because the purported "ethical lapses"

are in reality simply a reflection of the explicit differences between federal public policy for patent practioners (who need not even be state-licensed lawyers) and New York State public policy. Thus, the New York court's holding cannot be reconciled with the decisions of this Court, or of the Fifth Circuit.[10]

B. Exclusive Federal Jurisdiction

The validity of the fee agreement – and thus Respondents' claim for rescission – turns on whether it is authorized under Section 10.64 and whether the New York Code may limit or define the terms under which a patent attorney who is a member of the New York bar (which Petitioner Bain is not) may accept an equity fee in return for patent legal services. Respondents' claim for rescission therefore squarely rests on the interpretation of federal patent law subject to the exclusive jurisdiction of the federal courts under 28 U.S.C. § 1338. *See Christianson*, 486 U.S. at 808-09.

Federal law requires courts to give "a broad construction to the 'relating to patents' language in Section 1338." *Jaskiewicz v. Mossinghoff*, 802 F.2d 532, 534 (D.C. Cir. 1986) (quoting *Panduit Corp. v. All States Plastic Mfg. Co., Inc.*, 744 F.2d 1564, 1574 (Fed. Cir. 1984)). Far from following this federal mandate, the trial court incorrectly determined that exclusive federal jurisdiction does not apply here, mistakenly reasoning that "this case does not sound in patent law because the 'interpretation of the patent laws *on the issues of priority and infringement are hardly at issue*.' " App. at 61a. This overly restrictive formulation

10. Petitioners acknowledge that, as patent attorneys who are members of a state bar, they are subject to discipline by that bar for acts committed during their practice, even if those acts were committed during the course of the attorney's practice before the PTO. *See Kroll v. Finnerty*, 242 F.3d 1359 (Fed. Cir. 2001). But the alleged misconduct under a state's ethics code cannot be based on conduct specifically authorized and encouraged by the federal patent laws. *Kroll*, was a disciplinary proceeding, not a civil action for contract recission and disgorgement of fees. The conduct complained of was not unique to patent practice much less sanctioned by the patent law and only the lawyers future conduct in connection with the general practice of law was in issue.

ignores this Court's "lenient standard for jurisdiction under 28 U.S.C. § 1338(a)," *U.S. Valves, Inc. v. Dray*, 212 F.3d 1368, 1371 (Fed. Cir. 2000), and runs directly contrary to a long line of decisions by this Court and the federal courts of appeals holding that exclusive federal jurisdiction is not limited to issues of patent priority and infringement, but extends to any "substantial question of federal patent law." *Christianson*, 486 U.S. at 808; *Cedars-Sinai Med. Ctr. v. Watkins*, 11 F.3d 1573, 1577-80 (Fed. Cir. 1993) (claims based on statute vesting title to inventions made in government labs to the United States, arise under the patent laws); *Franchi v. Manbeck*, 947 F.2d 631, 633-34 (2d Cir. 1991) (mandamus claims related to PTO qualifying exam arise under the patent laws); *Morganroth v. Quigg*, 885 F.2d 843, 846 (Fed. Cir. 1989) (claims relating to PTO's refusal to revive abandoned patent application arise under the patent laws); *Wyden v. Comm'r of Patents & Trademarks*, 807 F.2d 934, 936-37 (Fed. Cir. 1986) (mandamus claims related to attorney's authority to practice before the PTO arise under the patent laws); *Alco Standard Corp. v. Tennessee Valley Auth.*, 808 F.2d 1490, 1493-94 (Fed. Cir. 1986); *Dubost v. PTO*, 777 F.2d 1561, 1564-65 (Fed. Cir. 1985). If the case turns "at least in part" on the patent laws, the federal courts have exclusive jurisdiction. *Helfgott*, 209 F.3d at 1333; *see also Hunter Douglas, Inc. v. Harmonic Design*, 153 F.3d 1318, 1328-29 (Fed. Cir. 1998), *overruled on other grounds by Midwest Indus., Inc. v. Karavan Trailers, Inc.*, 175 F.3d 1356 (Fed. Cir. 1999) (en banc). Indeed, there can be no more substantial question of patent law than the interpretation and application of a regulation issued by the PTO governing the practice of patent law.

The New York Court of Appeals' refusal to acknowledge exclusive federal jurisdiction simply because Respondents omitted Section 10.64 from the complaint (App. 14a) was manifest error. The mere fact that the face of Respondents' self-serving complaint does not specifically plead or cite a statutory element of federal patent law such as the PTO Code is irrelevant to the determination of exclusive federal jurisdiction. Plaintiffs cannot avoid or defeat exclusive federal jurisdiction through

artful pleading or ignorance of the applicable law. *See Rivet v. Regions Bank of La.*, 522 U.S. 470, 475 (2000) (plaintiff may not defeat removal by failing to plead necessary federal question); *Christianson*, 486 U.S. at 809 ("Just as a plaintiff may not defeat removal by omitting to plead necessary federal questions in a complaint, so a plaintiff may not defeat § 1338(a) jurisdiction by omitting to plead necessary federal patent-law questions") (internal citations and quotations omitted); *State ex rel. Nixon v. Coeur D'Alene Tribe*, 164 F.3d 1102, 1109 (8th Cir. 1999). "Once an area of state law has been completely preempted" – like equity-based fees between inventors and their patent lawyers – "any claim purportedly based on that pre-empted state law claim is considered, from its inception, a federal claim, and therefore arises under federal law." *Rivet*, 522 U.S. at 476. Were it otherwise, fifty state courts could reach different decisions regarding the scope of Section 10.64 on the same facts. Not only would this violate the Congressional mandate embodied in the creation of the Federal Circuit to promote uniformity in the field of patent law, it would cause disarray in the field of patent law, not to mention utter confusion in the patent bar. *See, e.g., In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1322-1324 (Fed. Cir. 2000) (holding the Federal Circuit is the only appellate court having the right and obligation to determine the extent that federal patent laws preempt state law); *Midwest Indus. v. Karavan Trailers, Inc.*, 175 F.3d 1356, 1360-61 (Fed. Cir. 1999) (en banc) (emphasizing the Federal Circuit has an "obligation [to] promot[e] uniformity in the field of patent law" and a "responsibility to decide what patent law permits and prohibits").

The Court of Appeals narrowly portrays this case as one about the "ethical obligations [attorneys] must maintain in the course of their interaction with clients." App. 14a. Again, however, this is *not* a disciplinary case. *See supra* n.10. Indeed, Petitioners are not simply (here, *not even*) lawyers practicing New York law. Petitioners represented Respondents in federal patent matters, and their interaction with their clients is governed by federal law in the form of the PTO Code. That the New York

Code may have something to say about fee arrangements between New York attorneys and their non-patent clients is irrelevant. (Moreover, it is impossible to understand how the New York Code applies at all to Petitioners, who were not practicing in New York, and particularly to Petitioner Bain who is *not even a member of the New York Bar*). State courts may not simply ignore federal patent law governing the conduct of patent attorneys because it prefers to apply conflicting state law and states may not add supplements to the federal scheme. This Court and the Fifth Circuit have expressly ruled that state bar rules must yield to federal rules governing the practice of patent law. *See Sperry*, 373 U.S. at 384; *Silverman*, 405 F.2d at 411; *see also Mikohn Gaming Corp. v. Acres Gaming, Inc.*, 165 F.3d 891, 896 (Fed. Cir. 1998) (federal law must be applied where there is conflict between state commercial law and federal patent law).

Once again, these issues affect the daily prosecution of patents nationwide. If patent practitioners are to be judged in state court by some combination of federal and state ethical standards, the congressional objective of a separate patent bar (that includes non-lawyers) and a uniformly interpreted and applied federal policy and ethics code will be undermined if not nullified.

II. Binding Petitioners To A Prior Determination In A Case In Which They Were Relieved Of Liability By Court Order Is Unconstitutional

The lower court bound Petitioners to the judicial determination of an issue that had been decided, not against them, but against a third party, in the *Rhodes* action. It did so despite the fact that the *Rhodes* court had expressly ruled it would have been unfair to bring Petitioners in as actual parties for the litigation of that issue. The majority reached this anomalous result on the basis of its holding that defendants were in privity with the losing party in *Rhodes*, a determination largely grounded upon Petitioners' and Rhodes' allegedly common interest in the validity of the fee agreement. App. 9a-11a.

Although the existence of privity is primarily a question of state law, the application of privity for preclusion purposes is constrained by federal due process requirements. *See, e.g., Richards*, 517 U.S. at 797-802 (holding that "there are clearly constitutional limits on the 'privity' " concept and determining the application of *res judicata* by the state court in that case to have been a violation of due process); *Aldrich v. Aldrich*, 378 U.S. 540, 543 (1964) ("[I]f the judgment is binding upon him, it is also binding on those whom Florida law considers to be in privity with him, so long as Florida does not seek to bind those who cannot be bound consistent with due process."). As the dissent eloquently explains, the lower court's broad expansion of offensive collateral estoppel contravenes due process of law as guaranteed by the Fourteenth Amendment. App. 33a-39a.

A. The Constitutional Standard: Issue And Claim Preclusion Raise Due Process Concerns Of The Highest Nature

It is a fundamental principle of American jurisprudence that "everyone should have his own day in court." *Richards*, 517 U.S. at 798 (internal quotation marks omitted); *accord Hansberry v. Lee*, 311 U.S. 32, 40 (1940). This principle is embedded in the due process guarantees of the Fourteenth Amendment to the United States Constitution, as this Court has repeatedly recognized. *See, e.g., Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 327 n.7 (1979); *Postal Tel. Cable Co. v. City of Newport*, 247 U.S. 464, 476 (1918).

For these constitutional reasons, this Court has established stringent requirements for the application of *res judicata* and collateral estoppel. This Court has expressly instructed that due process prohibits courts from binding a litigant to an adverse determination made in a prior proceeding in which he was not actually a party, or at least in privity with a party. *See Provident Tradesmens Bank & Trust Co. v. Patterson*, 390 U.S. 102 (1968); *Postal Tel. Cable Co.*, 247 U.S. at 476. This rule flows squarely from the fundamental principle that a party can be precluded

from litigating only if already given "a full and fair opportunity to litigate" the claim or issue in the prior action. *Johnson v. De Grandy*, 512 U.S. 997, 1005 (1994); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 480-481 (1982).

For these reasons, this Court has often examined the constitutional underpinnings of claim and issue preclusion. Almost by definition, improper application of these doctrines is a denial of due process. Improper *articulation* of these principles by a state's highest court, however, threatens widespread violations of due process and resulting damage.

Here the Court of Appeals committed two significant errors in its application of *res judicata*. *First*, the Court mistook (limited) commonality of interest as "privity" sufficient to preclude Petitioners from presenting their case. *Second*, the Court applied *res judicata* into the teeth of a court order in the prior action that relieved Petitioners of any liability (or interest) in that prior action.

B. *Richards v. Jefferson County*: Common Interest Is Insufficient To Create Privity

Due process limits the extent to which a state court can bind non-parties to prior judgments by preclusion principles. In *Richards*, this Court reiterated that due process limits a state court's power to categorize parties as privies for purposes of preclusion law and explained:

> The limits on a state court's power to develop estoppel rules reflect the general consensus in Anglo-American jurisprudence that one is not bound by a judgment in personam in a litigation in which he is not designated as a party or to which he has not been made a party by service of process. This rule is part of our deep-rooted historic tradition that everyone should have his own day in court. . . .

517 U.S. at 798 (internal quotations and citations omitted).

The Court recognized the privity exception to the general rule that non-parties may not be bound by a prior judgment, but expressly warned that "there are clearly constitutional limits on the 'privity'

exception." *Id.* In *Richards*, the Alabama Supreme Court relied on privity to preclude a set of taxpayer-plaintiffs from litigating the constitutionality of a county tax in a suit against Jefferson County. *See Jefferson County v. Richards*, 662 So. 2d 1127, 1129-30 (Ala. 1995). Noting that the *Richards* plaintiffs were asserting claims identical to those that had been unsuccessfully brought by the City of Birmingham and other taxpayers against the county in a prior action, the Alabama Supreme Court concluded that taxpayers were in privity with the city and prior taxpayers. *See id.* at 1128, 1130. As this Court explained, the Alabama Supreme Court applied privity-based preclusion on the theory that the plaintiffs in the prior lawsuit had "adequately represented Petitioners because their respective interests were essentially identical." *Richards*, 517 U.S. at 796.

This Court unanimously reversed, holding the Alabama Supreme Court's broad application of privity-preclusion infringed the *Richards* plaintiffs' due process rights. Importantly, as the Seventh Circuit has noted, the *Richards* Court "squarely rejected the Alabama Supreme Court's conclusion that *res judicata* could apply because the later plaintiffs were adequately represented in the earlier suit, not because it disagreed with the Alabama court's assessment of the nature of the earlier representation, but because this fact alone was not enough." *Tice*, 162 F.3d at 972.

Analyzing the case before it, the Court ruled that the following factors compelled the conclusion that the Alabama Supreme Court's application of *res judicata* was so extreme as to violate due process:

- *First*, the *Richards* petitioners never received notice that the earlier case "would conclusively resolve their legal rights." (Here, Petitioners *prevailed* in opposing a belated motion to bring them into the case.)
- *Second*, "their pleadings did not purport to assert any claim against or on behalf of any nonparties." (Likewise here, until the motion to amend was filed.)

- *Third*, "the judgment [in the prior action] did not purport to bind any [] nonparties." (Likewise herein.)

Richards, 517 U.S. at 799. Thus, this Court unanimously held that:

> As a result, there is no reason to suppose that the [prior] *Bedingfield* court took care to protect the interests of Petitioners in the manner suggested in *Hansberry*. Nor is there any reason to suppose that the individual taxpayers in *Bedingfield* understood their suit to be on behalf of absent county taxpayers. Thus, to contend that the plaintiffs in *Bedinfield* somehow represented Petitioners, let alone represented them in a constitutionally adequate manner, would be "to attribute to them a power that it cannot be said that they had assumed to exercise."

Id. at 802 (quoting *Hansberry*, 311 U.S. at 46).

The factors this Court relied upon in holding that due process of law had been denied in *Richards* apply equally or more powerfully to Petitioners here. Most important, Petitioners were never put on notice that their rights would – or even might – be conclusively resolved by the prior litigation. Quite the opposite: Petitioners were told – by court order no less – that no claims against them were being, or could be, litigated against them in the *Rhodes* action. App. 72a-74a.

Following this Court's decision in *Richards*, several federal circuit courts have made clear that a court cannot apply privity-preclusion solely on the basis of an identity of interests, however close, between a current party and a party to a prior lawsuit. *See, e.g.*, *Becherer*, 193 F.3d 415 (en banc); *Tice*, 162 F.3d 966. By ignoring this rule, the New York courts prohibited Petitioners from bringing their own unique, personal and separate defenses such as equitable estoppel, waiver and novation which were not and could not have been raised in the *Rhodes* action.

The Sixth Circuit's opinion in *Becherer* illustrates the conflict between the expansive preclusion law adopted by the majority below and the permissible boundaries of privity-preclusion as

articulated by federal circuit courts. The district court in *Becherer* found a second group of plaintiffs (the "Florida plaintiffs") to be privies with a prior set of plaintiffs (the "Becherer plaintiffs") on the basis of a relationship far closer than the relationship between Rhodes and Petitioners, but the Sixth Circuit reversed.

The *Becherer* Case:	**The Instant Case:**
• Both sets of plaintiffs were investors in a Florida hotel development. *Becherer*, 193 F.3d at 418.	• Rhodes and Petitioners were parties to the same original fee arrangement, but that agreement underwent fundamental revisions over time. App. 1a-2a.
• Each of the Florida plaintiffs was a member of the Association of Unit Owners, which had "authorized, financed and controlled the investigation and prosecution of the Becherer plaintiffs' lawsuit." *Id.* at 420.	• Petitioners had no involvement in the authorization, finance or control of the *Rhodes* action. Indeed, Petitioners were on opposite sides of *Rhodes* and served as patent counsel for Respondents for *eight years* while the *Rhodes* action was litigated. App. 119a.
• "Florida plaintiffs' counsel, Thomas Grady, told a Florida court in 1990 that the resolution of the *Becherer* case in the Eastern District of Michigan would determine the rights of his clients in the Florida case." *Id.* at 420.	• Petitioners never acknowledged that they would be bound by the *Rhodes* action. Indeed, the *Rhodes* court affirmatively put Petitioners on notice that their interests were *not* in jeopardy in the *Rhodes* action. App. 73a.
• "[Florida plaintiffs' counsel] acknowledged that the Florida plaintiffs' interests were congruent to those of the AUO." *Id.* at 421.	• Petitioners never had the same interests as *Rhodes* nor ever hinted at any such common intent; in fact, they opposed the filing of Rhodes' lawsuit. App. 1a-5a.

The *Becherer* Case:	The Instant Case:
• "22 Florida plaintiffs signed affidavits requested by [counsel for the Becherer plaintiffs] opposing defendants' motion for summary judgment." *Id.* at 420.	• Petitioners never signed a single affidavit supporting any motion by *Rhodes*. App. 1a-5a.
• "The Becherer plaintiffs claimed to adequately represent the Florida plaintiffs' interests." *Id.* at 421.	• Rhodes never claimed to represent Petitioners. App. 1a-5a. Rhodes could not and did not raise defenses available only to Petitioners.
• "[T]he Florida plaintiffs improperly maneuvered in order to avoid the potential effects of *res judicata*." *Id.* at 421.	• The *Rhodes* court affirmatively put Petitioners on notice that their interests were *not* in jeopardy in the *Rhodes*. App. 73a.

Accepting the district court's factual findings as true, the Sixth Circuit concluded that due process did not permit the Florida plaintiffs to be bound by the determination rendered against the Becherer plaintiffs. Focusing upon the adequate/virtual representation theory, which had been the district court's primary basis for finding privity, the *Becherer* court explained that "adequate representation" denotes an express or implied *legal* relationship in which parties to the first suit are *accountable* to non-parties who file a subsequent suit raising identical issues." *Id.* at 424 (quoting *Benson and Ford, Inc. v. Wanda Petroleum Co.*, 833 F.2d 1172, 1175 (5th Cir. 1987)) (internal quotation marks omitted) (emphasis in original). The *en banc* court concluded that, even on the basis of the extensive set of facts outlined above, "there is no evidence that the Florida plaintiffs here could have held the Becherer plaintiffs, the [Association of Unit Owners] or [their attorney] legally accountable for the result of the *Becherer* litigation." *Id.* Since they could not, the Sixth Circuit concluded that the district court's application of privity-preclusion conflicted with this Court's holding in

Richards and thus deprived the Florida plaintiffs of their due process rights. *See id.* at 427. In the present case, it is clear that Rhodes was accountable to no one but Rhodes.

In *Tice*, the Seventh Circuit noted that *Richards* re-affirmed the "importance the Court attaches to assuring each person his or her own day in court." *Tice*, 162 F.3d at 972. The *Tice* court interpreted *Richards* as supporting "[a] proper functional analysis of privity, focusing on the general question whether the earlier parties were in some sense *proper agents* for the later parties." *Id.* at 971 (emphasis added). A party can be precluded based upon another parties' earlier litigation if, and only if, the facts indicate that the earlier party was an *agent* for the later party. *See id.* at 971-72. In *Tice*, the Seventh Circuit allowed a group of American Airlines pilots to assert a claim under the Age Discrimination in Employment Act even though a different group of pilots and the Equal Employment Opportunity Commission had each previously asserted, unsuccessfully, similar challenges to the same American Airlines policy in separate prior actions. *See id.* at 973-74. It found that there was no basis upon which the first set of pilots could said to have been agents for the *Tice* plaintiffs, because there was no relationship between the two sets of plaintiffs other than that they were all American Airlines pilots. Similarly, the EEOC had not acted as the actual representative of the *Tice* plaintiffs.

In the instant case, the New York Court of Appeals based its privity finding principally upon the fact that Petitioners and Rhodes were co-signatories to a fee agreement entered into in 1974 with Respondents, and thus had "rights to receive payments . . . coextensive with Rhodes." App. 10a. This legal ruling, however, is in direct conflict with the basic message of *Richards*, *Becherer* and *Tice*. Thus, the fact that Petitioners and Rhodes all had an interest in the original fee agreement (which was changed repeatedly in the ensuing years) is not, under the due

process holdings of *Richards*, *Becherer*, and *Tice*, sufficient to create privity and to bind Petitioners to the rulings of the *Rhodes* action.[11]

In its only footnote, the Court of Appeals majority strives to insulate its decision from review by stating that a "confluence of factors" was dispositive to its holding, listing Petitioners' relationship with Rhodes, their involvement in the *Rhodes* action, their awareness of issues to be decided and their so-called tactical decisions. App. 13a. n.1. However, each of the factors identified was present to a similar extent, or even greater, in *Richards, Becherer* and *Tice*.[12] None of those cases found privity constitutionally permissible. Thus, the lower court's opinion stands in unavoidable conflict with the due process analysis in *Richards*, *Becherer* and *Tice*.

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11. None of the traditional grounds giving rise to privity were present in this case. The most traditional form of privity occurs where one party's rights are derivative upon another's. *See Richards*, 517 U.S. at 798. A second established form of privity is where one party exercised a degree of control over another party's litigation of a prior action. *See* Restatement (Second) of Judgments § 39.

The majority below did not cite either of these forms of privity, and there is no tenable basis to conclude that either apply. Petitioners' rights were in no way conditional upon or derivative of Rhodes' rights in the prior litigation. The fact that Petitioners and Rhodes were law partners until 1981 does not alter this conclusion. Indeed, it is well established in New York (and elsewhere) that there is no privity when the relationship which allegedly creates privity terminates prior to the dispute. *See, e.g.*, *Comi v. Breslin & Breslin*, 257 A.D.2d 754 (3d Dep't 1999). This is especially so where, as here, the relationship between Rhodes and Petitioners had turned openly hostile and acrimonious by the time that Rhodes commenced the *Rhodes* action (six years after his partnership with Petitioners terminated). Neither is there a scintilla of evidence that defendants even participated in – much less coordinated or controlled – Rhodes' litigation of his case.

12. Moreover, the *Rhodes* opinion itself established that Petitioners and Rhodes had widely divergent interests, finding that Rhodes had engaged in activities contrary to Petitioners' interests. App. 87a-88a.

C. The Offensive Use of *Res Judicata* To Bind Petitioners To The *Rhodes* Decision – Particularly Where The *Rhodes* Court Expressly Relieved Petitioners Of Potential Liability – Directly Conflicts With This Court's And The Federal Courts Of Appeals' Due Process Jurisprudence.

This case does not involve the typical defensive use of *res judicata* or collateral estoppel. Rather, Respondents have persuaded the Court of Appeals to apply *res judicata* offensively to avoid a trial – and even to preclude discovery – and to summarily award millions of dollars in damages against two individuals nearing the end of their professional careers who have never had their day in court. This *offensive* use of preclusion raises fundamental fairness and due process concerns that implicate constitutional rights of the first order. *See Parklane Hosiery*, 439 U.S. at 329-31 (warning that offensive collateral estoppel should be allowed sparingly). And the lower court's *vicarious* offensive use of privity-preclusion strikes at the very heart of a litigant's right to due process of law.

The fundamental requisite of due process is the right to notice and a full and fair opportunity to be heard. *See Cleveland Bd. of Ed. v. Loudermill*, 470 U.S. 532, 542 (1985). Although Petitioners were eventually joined in *Rhodes* as defendant-beneficiaries in the caption of that action, all claims in that action were solely between Rhodes and Respondents. Petitioners received the first and only notice of a claim being asserted against them when Respondents moved on the eve of trial to amend their counter complaint. They acted immediately to oppose the motion to amend, and they prevailed. Thus, the trial court in the instant action issued an order that denied that motion and *relieved Petitioners of liability in the Rhodes case*. In effect, Petitioners were put on notice that the claims against them were *not* going to be determined in *Rhodes*.

This Court recognized long ago that the right to be heard has little value without a requirement that a party be given notice of the claims being asserted against him. *See Mullane v. Central*

Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950). How could Petitioners have reasonably been expected to mount a meaningful defense without being informed – even by minimal notice pleading requirements – of what the claims against them were? Indeed, this is the *opposite* of notice: Petitioners were relieved of liability in *Rhodes*, and told in effect that they could go home. This is also the *opposite* of *res judicata*: Petitioners *prevailed* in the only part of the *Rhodes* case in which they participated, the only part that is pertinent to the present claims.[13]

Petitioners believe that their reliance on the denial of the motion to amend was entirely reasonable. They "went home," as it was their right to do. Petitioners believe that the New York courts' later contradictory rulings, which bind Petitioners to the ruling made after Respondents' motion to amend was denied, are not just unconstitutional, but absurdly so.

Compounding this lack of notice, or notice-opposite, was the absence of any opportunity to conduct discovery. As Judge Levine explained below:

> New discovery would have been vital to all parties and especially [Petitioners], if they had had been joined on the counterclaim, because their affidavits herein show that they had extensive dealings with [Respondents] separate from Rhodes, both before and after his withdrawal from the law partnership. .
>
> . .
>
> Surely, the total absence of participation [in the *Rhodes* action], including the entire loss of opportunity for discovery, occasioned by the *Rhodes*

13. Several courts have held that the denial of a motion to amend bars a plaintiff from re-asserting those same claims in a subsequent action. *See, e.g.*, *Landscape Props., Inc. v. Whisenhunt*, 127 F.3d 678, 683 (8th Cir. 1997) ("It is well settled that denial of leave to amend constitutes *res judicata* [against plaintiffs] on the merits of the claims which were the subject of the proposed amended pleading."); *EFCO Corp. v. U.W. Marx, Inc.*, 124 F.3d 394 (2d Cir. 1997); *King v. Hoover Group, Inc.*, 958 F.2d 219, 222-23 (8th Cir. 1992); *Huck v. Dawson*, 106 F.3d 45, 49-50 (3d Cir. 1997); *Walton v. Eaton Corp.*, 563 F.2d 66 (3d Cir. 1977).

> trial court's refusal to grant [Respondents'] motion to join defendants on their counterclaim, must also be a denial of a full and fair opportunity to litigate.

App. 22a-23a.

Because Petitioners were not given (i) notice of claims being asserted against them in the *Rhodes* action, (ii) any opportunity, ever, to take discovery on such claims or (iii) an opportunity to be heard on the merits of those claims, the due process difficulties are manifest. When compounded by the message sent by the *Rhodes* court when it denied the motion to amend, those difficulties become basic and manifest injustice.

Having been freed of liability and litigation in *Rhodes*, Petitioners were bound retroactively to the judgment in *Rhodes*, as if they had actually litigated that case. This order resulted in an outcome far more prejudicial than if Respondents' eve-of-trial motion in *Rhodes* had been granted. Here, Petitioners were afforded no chance to defend themselves. Indeed, they were told by the *Rhodes* court itself that their rights would not be adjudicated in that action. Then they discovered, to their understandable dismay, that their rights had *already been* adjudicated. Due process mandates that Respondents' claims against Petitioners be allowed to stand or fall on their own, unique merits in a forum where Petitioners are there to defend themselves. The New York courts have done everything but afford due process to Petitioners.

CONCLUSION

For the foregoing reasons, Petitioners respectfully submit that a writ of certiorari to the New York Court of Appeals should be granted and that this case should be heard by the Supreme Court on the issues of law raised by this petition.

Respectfully submitted,

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APPENDIX A — OPINION OF THE COURT OF APPEALS, STATE OF NEW YORK DATED DECEMBER 20, 2001

COURT OF APPEALS OF NEW YORK

No. 134
Dec. 20, 2001

Frederick F. Buechel, M.D., et al.,

Respondents,

v.

John N. Bain, et al.,

Appellants, et al., Defendants.

SMITH, J.:

The primary issue before this Court is whether parties should be precluded from relitigating the validity of fee arrangements determined to be illegal in an earlier action, when they were in privity with the person against whom the issue was decided. We conclude that collateral estoppel bars relitigation.

Plaintiffs, Frederick F. Buechel, an orthopedic doctor and Michael J. Pappas, a mechanical engineer, are the inventors of a prosthetic shoulder device called the floating center prosthetic joint. They retained the firm of Bain, Gilfillan & Rhodes, P.C. "to undertake the preparation and prosecution of a patent application covering the invention on a contingency basis." The fee agreement, executed on

November 12, 1974, provided that the law firm would receive a one-third interest in monies, profits or income resulting from the invention.

In July 1975, the parties formalized their relationship and incorporated Biomedical Engineering Corporation (BEC) in New Jersey. The attorneys' interests in the corporation mirrored their fee agreement. Plaintiffs each held one-third of the shares of the corporation, with the remaining one-third interest divided equally among Bain, Gilfillan and Rhodes. Plaintiffs, who had continued to collaborate on development of prosthetic devices, assigned to BEC their interests in the floating center prosthetic joint and any future prosthetic devices invented by them. Significantly, Rhodes failed to advise plaintiffs of the potential for conflicts of interest that could result from converting the one-third interest in a single invention into a one-third equity interest in a corporation that would exploit all future inventions. A dispute subsequently arose among the attorneys, resulting in Rhodes' departure from the firm in December 1981. Defendants Bain and Gilfillan, however, continued to render legal services to plaintiffs on BEC matters.

In 1983, for tax purposes, BEC was dissolved, and its assets were transferred to a newly formed entity, the Biomedical Engineering Trust (Trust I), also with plaintiffs as trustees. Again, the trust agreement continued the parties' prior arrangement. The three attorneys, as shareholders of the dissolved corporation, received equivalent equity interests in the trust. In 1984, a second trust, the Biomedical Engineering Trust II (Trust II) was created, again with plaintiffs as trustees, and it held the marketing rights to a

self-centering hip device. While neither Bain nor Gilfillan held an interest in Trust II, their former partner, Rhodes, provided patent protection services to the entity.

In 1987, after a dispute arose over trust distributions, Rhodes commenced an action against plaintiffs as trustees to recover monies that the trustees allegedly improperly paid themselves. In response to plaintiffs' motion to dismiss for failure to join all the trustees, Rhodes amended his complaint, adding defendants Bain and Gilfillan in their capacity as trust beneficiaries. In 1991, four years after Rhodes commenced the action, plaintiffs asserted counterclaims against Rhodes for breach of fiduciary duty and malpractice, alleging among other things that "the agreements were unfair" and that Rhodes "while acting as their attorney, induced [plaintiffs] to enter into the unfair agreements by taking unfair advantage of his fiduciary capacity and superior knowledge, by deceiving [plaintiffs] as to the value of his and/or the law firm's services and by failing to disclose * * * the value of the one-third interest relinquished by the inventors." Plaintiffs additionally asserted malpractice on the part of Rhodes in that he represented that he and his law firm were qualified, competent and experienced in patent and business affairs, which representations were false. Plaintiffs did not, at that time, name defendants as adverse parties. In a later letter sent to defendants, Rhodes' attorney made clear that if the counterclaims were established, recovery for the counterclaims "[would] be subject to contribution by [defendants] Rhodes' former partners."

Recognizing their unity with Rhodes in regard to the validity of the challenged fee arrangement, on March 12,

1992, Bain wrote plaintiffs that he was unclear as to how the counterclaims could be narrowly construed solely against Rhodes. Bain wrote that he and Gilfillan were "concerned that the counterclaims could be interpreted broadly to assert overreaching either by the law firms in which Rhodes, Gilfillan and I were involved or, at the least by Rhodes as a partner or agent of those law firms, thereby potentially extending the consequences of the alleged wrongdoing by Rhodes to Gilfillan and myself."

On January 5, 1995, after a number of disputes, Gilfillan wrote plaintiffs:

> "With the trial date apparently becoming imminent, you have placed John [Bain] and I[sic] in a position where we have to deal with the question of whether or not we must become active in the Rhodes' litigation to protect our rights, vis-a-vis the position of the Trustees regarding legal fees. I would certainly not like to have to do that. However, I will not waive any rights. We are gravely concerned that if we do not raise the issue in this litigation or otherwise provide for preservation rights, we will be estopped in the future from challenging the Trustees on this highly improper conduct. Needless to say, we cannot let this happen."

On January 10, 1995, plaintiffs fired Bain and Gilfillan and moved to amend their counterclaims in the *Rhodes* action to assert specific claims against them. Defendants opposed the motion. Supreme Court denied plaintiffs' motion because they failed to offer an acceptable excuse for the delay.

Plaintiffs then commenced the present action against defendants Bain and Gilfillan, alleging breach of fiduciary and ethical obligations and legal malpractice. Plaintiffs sought the termination of trust payments to defendants and the turnover of trust files. At defendants' request, Supreme Court stayed the action pending resolution of the *Rhodes* action. In support of their request for a stay, defendants submitted an affidavit to the court arguing:

> "Because of the similarity of the underlying facts and transactions in both the *Rhodes* action and this one, proceeding with this action at this time would be duplicative and a waste of judicial resources. Indeed, a decision in the *Rhodes* case may estop or bar certain claims in this action."

In 1998, following a bench trial, Supreme Court determined in the *Rhodes* action that the fee arrangement between plaintiffs and their original counsel, the firm of Bain, Gilfillan & Rhodes, was invalid. The court found that, from the outset of the attorney-client relationship, there had not been full disclosure regarding the possibility of the firm's conflict of interest. The court further found that plaintiffs were never advised to seek independent counsel before entering into a business relationship with their attorneys, and that Rhodes had "exploited his clients through affirmatively pursuing a business relationship with them absent full disclosure." The court noted that Rhodes' extensive ethical violations constituted serious breaches of his fiduciary obligation "not to take advantage of his superior knowledge and position," and that he failed to inform his clients that he could be discharged as their attorney at any time.

Consequently, Supreme Court held that the fee agreement, from which Rhodes derived his interest in the trusts, was unethical and unenforceable, and in its decision the court ordered that "the trust agreements are rescinded."

The Appellate Division affirmed, concluding "neither the initial arrangement nor its subsequent incarnations were entered into upon adequate disclosure * * * of other possible fee arrangements and potential conflicts of interest, or with the aid of independent counsel * * *. Rescission of the parties' arrangements *ab initio*, with payment to plaintiff in *quantum meruit* for his services, is an equitable result * * *" (258 A.D.2d 274 [1999] [citations omitted]). This Court declined to hear the appeal (93 N.Y.2d 806 [1999]).

By order dated February 5, 1998, Supreme Court lifted the stay in the present suit, and on March 23, 1998, defendants Bain and Gilfillan answered the complaint and asserted counterclaims, seeking their reinstatement as beneficiaries of the Trust. Defendants alleged that plaintiffs "repudiated their agreements with Bain and Gilfillan and now contend that all such agreements are void *ab initio*." Both parties moved for summary judgment. Supreme Court granted plaintiffs' motion for partial summary judgment, rescinding and terminating defendants' equity interests in Trust I and ruled the fee agreements between plaintiffs and defendants unenforceable, *ab initio*, "because they were entered into in violation of the ethical duties owed to plaintiffs." The court directed defendants to return to plaintiffs all monies distributed less reasonable attorneys' fees.

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The court explained that the issue of rescission was thoroughly litigated in the *Rhodes* action, and that defendants had elected to elude every opportunity to participate actively. Supreme Court determined that defendants were in privity with Rhodes, that they "actually did cooperate somewhat in [his] trial preparation," and that on "this score absolutely no adverse relationship existed between them." Finally, the defendants had not shown that their failure to more fully participate in the *Rhodes* action prejudiced them or affected its outcome. The court stated, "judging by the context of defendants' affidavits in the present action, their testimony in the *Rhodes*' action, even assuming its veracity, would not have met the standard of professional conduct applied in the prior case, having failed to allege *inter alia*, that plaintiffs were informed their attorneys could be replaced without penalty."

The Appellate Division unanimously affirmed. The court rejected the contention that "Bain and Gilfillan were merely nominal parties to the *Rhodes* matter," explaining that:

> "The issue presented for decision in *Rhodes* was whether or not Buechel and Pappas, as trustees, were required to make payments to an attorney whose rights *as a trust beneficiary* derived from the fee agreement between Buechel and Pappas, individually, and the law firm of Bain, Gilfillan & Rhodes. This action similarly addresses the status of attorney-beneficiaries whose rights to receive proceeds from the trust are predicated on the identical fee agreement"

(275 A.D.2d 65, 71-72 [emphasis in original]).

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On motion for reargument, defendants contended that the claims against them for nullification of the fee agreement were not precluded. They also argued, for the first time, that plaintiffs were barred from bringing suit against them under the doctrine against claim splitting. The Appellate Division denied the reargument motion and certified the following question to this Court: "Were the orders of the Supreme Court, as affirmed by this Court, properly made?" We conclude that they were.

Analysis

The equitable doctrine of collateral estoppel is grounded in the facts and realities of a particular litigation, rather than rigid rules. Collateral estoppel precludes a party from relitigating in a subsequent action or proceeding an issue raised in a prior action or proceeding and decided against that party or those in privity (*Ryan v. New York Tel. Co.*, 62 N.Y.2d 494, 500 [1984]). The policies underlying its application are avoiding relitigation of a decided issue and the possibility of an inconsistent result (*D'Arata v. New York Cent. Mut. Fire Ins. Co.*, 77 N.Y.2d 659, 664 [1990]).

Two requirements must be met before collateral estoppel can be invoked. First, the litigant seeking the benefit of collateral estoppel must demonstrate that the decisive issue was necessarily decided in the prior action against a party, or one in privity with a party (*see, Gilberg v. Barbieri*, 53 N.Y.2d 285, 291 [1981]). Second, the party to be precluded from relitigating the issue must demonstrate the absence of a full and fair opportunity to contest the prior determination.

The doctrine, however, is a flexible one, and the enumeration of these elements is intended merely as a framework, not a substitute, for case-by-case analysis of the facts and realities. "In the end, the fundamental inquiry is whether relitigation should be permitted in a particular case in light of * * * fairness to the parties, conservation of the resources of the court and the litigants, and the societal interests in consistent and accurate results. No rigid rules are possible, because even these factors may vary in relative importance depending on the nature of the proceedings * * *" (*see, Staatsburg Water Co. v. Staatsburg Fire Dist.*, 72 N.Y.2d 147, 153 [1988] [citations omitted]).

Applying these principles, we conclude that defendants are barred from now once again litigating the validity of a trust agreement that was — after extensive pretrial and trial proceedings involving them—found to be invalid.

In determining whether collateral estoppel applies here, the initial question is whether defendants — parties in the *Rhodes* action who were not named in the plaintiffs' counterclaim — should, nevertheless, be bound by the determination rescinding the Trust. Because for purposes of collateral estoppel, defendants were in privity with their former law partner Rhodes as to the validity of the fee arrangements, we conclude they should be bound.

In the context of collateral estoppel, privity does not have a single well-defined meaning (*Matter of Juan C. v. Cortines*, 89 N.Y.2d 659, 667 [1997]). Rather, privity is "an amorphous concept not easy of application * * * and includes those who are successors to a property interest, those who control an

action although not formal parties to it, those whose interests are represented by a party to the action, and (those who are) coparties to a prior action" (*id.*, at 667-668 [citations omitted]). In addressing privity, courts must carefully analyze whether the party sought to be bound and the party against whom the litigated issue was decided have a relationship that would justify preclusion, and whether preclusion, with its severe consequences, would be fair under the particular circumstances. Doubts should be resolved against imposing preclusion to ensure that the party to be bound can be considered to have had a full and fair opportunity to litigate.

For present purposes, Bain and Gilfillan were in privity with their former law partner, Rhodes, as he was a co-signatory to the fee agreement and co-beneficiary to the Trust proceeds arising from the fee agreement. Considering the facts and realities of the matters before us, we agree with the Appellate Division that defendants should be deemed to be in privity with Rhodes for purposes of litigating the validity of their fee arrangements as embodied in the trust. Defendants' rights to receive payments were coextensive with *Rhodes* and derived from the identical arrangement entered into when the three were law partners. As the Appellate Division concluded, "[a]s partners in the law firm that entered into the fee agreement with plaintiffs, [Bain and Gilfillan's] right to receive trust income stands or falls with the contract." Indeed, defendants themselves recognized that adjudication of *Rhodes*' conduct as a partner or agent of the law firm would have consequences for them. Defendants' interests were aligned with Rhodes with respect to the lawfulness of the fee arrangements where millions of dollars were at issue. Thus, it is appropriate to bind them by the judgment in *Rhodes* under the doctrine of collateral estoppel.

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Defendant trustees — parties to the *Rhodes* action with notice of the issues to be decided in that case — acknowledged that they were themselves "unclear as to how the wording of portions of the counterclaim [could be] narrowly construed" to exclude them. Given these facts, as a policy matter we agree with the Appellate Division that a "party to a lawsuit cannot sit by idly while a contract, to which he is also a party, is judicially construed without being precluded by the result" (*supra*, 275 A.D.2d, at 74).

Knowing that the validity of the trust was being vigorously contested in *Rhodes,* and knowing the potential serious adverse consequences of the litigation, in this particular case it is appropriate to deem defendants' interests represented by *Rhodes.* Defendants cannot be rewarded for their conscious, tactical decision not to take a more active role in that litigation by now allowing the very same issues and facts to be relitigated. A contrary determination would undermine a policy interest that is at the heart of collateral estoppel — discouraging relitigation of issues and the potential for inconsistent outcomes.

We turn next to whether the two basic requirements for collateral estoppel have been met.

A comparison of the issue raised in the present action with the issue raised in the *Rhodes* action reveals that the identical issue was already litigated and decided. In the *Rhodes* action, Supreme Court determined, after extensive pretrial and trial proceedings, that the original fee agreement was unlawful as it was procured in violation of the canons of ethics. Supreme Court further concluded "that with regard

to fees, the Trust Agreement merely recodified the prior fee arrangements entered into" and that because "plaintiffs did not have the benefit of truly independent counsel and were never instructed to seek [independent legal] advice * * * the trust agreements are rescinded." This is the very issue that defendants seek to relitigate in the present action hoping that the second time around a court will reach a contrary determination.

Defendants, moreover, have failed to establish the lack of a full and fair opportunity to litigate the validity of the fee agreement in the *Rhodes* action. Because defendants were in privity with Rhodes, the critical question is whether Rhodes had a full and fair opportunity to litigate the issue (*see, D'Arata v. New York Cent. Mut. Fire Ins. Co., supra*, 76 N.Y.2d, at 666). We conclude that he did. In extensive proceedings, Rhodes vigorously defended the validity of the trust. Moreover, as noted by the Appellate Division, defendants were not just nominal parties but, as trust beneficiaries, were essential parties whose rights were affected by the outcome of the *Rhodes* action. The record reflects that defendants produced documents for the litigation, received copies of select documents used in the trial (including deposition transcripts), and agreed to testify as witnesses on behalf of Rhodes before changing their minds at the last minute.

Defendants make much of the fact that Supreme Court denied plaintiffs' motion to amend their counterclaims to assert claims against defendants. While true, this fact does not undermine the holding of *Rhodes* which disposed of the essential claim in the instant action in holding the fee

agreement was unenforceable. All that denial of the motion to amend guaranteed was that defendants would not be subject to a monetary judgment in the *Rhodes* action. Additionally, it was defendants who beseeched the trial court to stay this action pending a determination in *Rhodes,* fully intending to invoke the benefits of the judgment if the outcome was favorable to them. Although, as the dissenting opinion points out, abolition of the mutuality of estoppel doctrine authorizes such use of issue preclusion, nothing in our case law correspondingly prohibits taking this fact into account in analyzing whether defendants — parties in the *Rhodes* action who had notice of all the proceedings—should be bound by a determination against one with whom they are united in interest as to the particular issue.* Moreover, it was defendants who vigorously opposed the expansion of the *Rhodes* case to include specific claims by Buechel and Pappas against Bain and Gilfillan. Defendants based their opposition on the prospect of additional delay in the *Rhodes* litigation.

Finally, defendants' claim that the present matter is subject to exclusive Federal jurisdiction is without merit.

* Further addressing the dissent, no one factor is determinative in our conclusion that defendants here were in privity with Rhodes. It is, rather, a confluence of factors that persuades us to affirm, including defendants' relationship with Rhodes vis-a-vis the fee arrangements, their involvement in the action, their awareness of issues that would be decided, and their acknowledged tactical decisions regarding the *Rhodes* litigation. Additionally, because we hold that collateral estoppel bars relitigation of the validity of the trust, defendants' conclusory affidavits (Dissenting Opinion, at 6) are irrelevant in this action.

This case is not preempted by patent law because plaintiffs, the inventors, did not plead any substantive questions of patent law as an element of the claims asserted against defendants. A case arises under patent law "when a well-pleaded complaint establishes either that federal patent law creates the cause of action or that plaintiffs right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims" (*Kroll v. Finnerty*, 242 F3d 1359, 1363 [2d Cir 2001]). Here, we agree with the determination of Supreme Court that this case does not sound in patent law because the "interpretation of the patent laws on the issues of priority and infringement are hardly at issue." Further, Federal patent statutes do not preempt State law in this case (*see*, 37 CFR § 10 .1 [stating that nothing in the [code] "shall be deemed to be construed to preempt the authority of each State to regulate the practice of law, except to the extent necessary for the Patent and Trademark Office to accomplish its Federal objectives"]). Nor do lower court decisions invalidate a patent attorney's right to receive an interest in a client's patent as full or partial payment (*see*, 37 CFR § 10.64 [3]).

Rather, this case addresses the necessary disclosures attorneys must make and the ethical obligations they must maintain in the course of their interaction with clients. Although Federal patent law recognizes that attorneys may receive an interest in patents in lieu of traditional fee arrangements, the need for disclosure mandated by the Code of Professional Responsibility governing the practice of law in this State is not obviated (*see*, 37 CFR § 10.1; *see also*, *Kroll v. Finnerty*, *supra*, 242 F3d, at 1364-1365).

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The basic problem with the dissent is that it does not acknowledge that the *Rhodes* judgment rescinded Rhodes' interest in the trusts because it found that the agreements from which the interest arose were invalid. Supreme Court stated: "[It is] Ordered, Adjudged and Decreed that since all of the agreements which purport to provide compensation for legal services, by the payment of money or by providing an interest in any trust * * * were entered into in violation of ethical duties owed by attorneys to their clients * * * the relief sought in the Third Counterclaim in the Verified amended Answer to the Third Amended Complaint * * * is granted, thereby terminating and rescinding, *ab initio,* any interests Rhodes holds, or may have held, in Trusts I and II." Plaintiffs here raise a question that has already been adjudicated, specifically, whether the fee agreement is invalid as resulting from a breach of duty by attorneys to their clients.

The dissent also misconstrues the test for privity that the Court employs. We do not adopt the so called "Virtual Representation Doctrine." That doctrine states that a nonparty may be bound by the results of a trial where the nonparty has sufficient ties to a litigant.

> "Virtual representation demands the existence of an express or implied legal relationship in which parties to the first suit are accountable to non-parties who file a subsequent suit raising identical issues. In reviewing cases decided under the doctrine, we have described the types of relationships contemplated: 'estate beneficiaries bound by administrators, presidents and sole stockholders by their companies, parent

> corporations by their subsidiaries, and a trust beneficiary by the trustee'. *Southwest Airlines Co. v. Texas Intern. Airlines*, 546 F.2d 84, 97 (5th Cir. 1977)"

(*Pollard v. Cockrell*, 578 F.2d 1002, 1008-1009 [1978]).

Moreover, *Green v. Santa Fe Indus., Inc.* (70 N.Y.2d 244 [1987]) is clearly distinguishable. There this Court held that an action by former minority stockholders against several corporations for breach of fiduciary duty was not barred by collateral estoppel. In *Green*, the only relationship between the party to be bound, and against whom the issue was decided, "was that they owned separate blocks of stock in the same company." Plaintiffs were not litigants in the prior Federal action and were determined by this Court not to be in privity with plaintiffs in that action. Here, by contrast, the relationship between defendants and Rhodes — former partners and co-trustees entitled to trust funds based on the identical fee agreement — coupled with defendants' litigation posture, compel a different result.

In the end, we cannot agree with our dissenting colleague that defendants' strategy was "understandable and legitimate" (Dissenting Opinion, at 12). Rather, we agree with the trial court and the unanimous Appellate Division that defendants, as parties to the action, were well aware that their own fee agreements were being challenged and construed, and they had an obligation to take an active role in that litigation — which went on for nearly a decade — or accept the consequences. Indeed, the record shows that defendants themselves knew of the potential costs of their gamble.

Our holding makes plain that the law will not sanction such tactical maneuvering at the price of efficiency and consistent judgments where parties have not shown that they lacked a full and fair opportunity to be heard.

Accordingly, the order of the Appellate Division should be affirmed, with costs, and the certified question answered in the affirmative.

Appendix A

LEVINE, J. (dissenting):

I respectfully dissent. In this case, the majority upholds the application of collateral estoppel to bar defendants from litigating an issue that had been resolved, not against them, but against a third party, at a prior trial. The majority so holds notwithstanding that the judge in that trial had ruled that it would have been unfair to bring them in as actual parties for the litigation of that issue in that forum. This anomalous (to say the least) result is purportedly reached by the majority on the ground that defendants were in privity with the losing party in the prior action. Nevertheless, the majority's writing is laced with party preclusion concepts, and it quotes approvingly from the portion of the Appellate Division's decision relying on that ground for preclusion. Thus, I will address both grounds, each of which is unsoundly applied here.

Party Preclusion

Defendants' former law partner, R. Gale Rhodes, commenced the prior action in 1987 against plaintiffs as trustees of two trusts, the corpuses of which were patents covering prosthetic devices plaintiffs had invented. Plaintiffs were the named trustees and each a one-third beneficiary in the two trusts. Rhodes and defendants were each a one-ninth beneficiary of the total royalty income derived from the patents held in "Trust I." Their beneficial interests accorded with the terms of a 1974 retainer agreement the plaintiffs had signed when Rhodes' and defendants' law firm undertook to provide the legal services for obtaining those patents, mostly accomplished before Rhodes withdrew from the firm

in 1981. Rhodes, but not defendants, was a beneficiary of "Trust II," compensating him for patent-related legal services to plaintiffs after he left the firm.

Count I of Rhodes' complaint pertained exclusively to plaintiffs' alleged breaches of fiduciary duty as the trustees of Trust I. He charged that plaintiffs unlawfully diverted and mishandled trust income for their own personal interests. Rhodes sought an accounting from plaintiffs and that they be personally surcharged and removed as trustees. As beneficiaries of Trust I, defendants would have been directly affected by the relief Rhodes requested. Hence, they concededly were necessary parties as to that cause of action, and Rhodes joined them as "defendant-beneficiaries" in response to plaintiff's motion to dismiss based upon nonjoinder. It is uncontroverted that they did not actively participate in the lawsuit, however.

Some four years after Rhodes initiated suit, plaintiffs, as individuals, interposed five counterclaims against him alone. Their third counterclaim sought *ab initio* rescission of *Rhodes' interest* in Trust I, on the ground that, as their attorney in processing the applications for the patents held in the trust, he had a conflict of interest and breached his fiduciary duty to them by inducing them to enter into a retainer agreement giving him a proprietary interest in their inventions. Four years later, plaintiffs sought for the first time to amend their answer to extend *that counterclaim* to defendants. That motion was denied.

Plaintiffs then brought this separate action against defendants, which was stayed while Rhodes' suit proceeded to trial. The trial concluded with a judgment in plaintiffs' favor on their third counterclaim.

On the foregoing procedural facts, the majority agrees with the Appellate Division that defendants are collaterally estopped, on the basis of their presence as "essential parties" in the prior action (*i.e.*, party preclusion), from defending the validity of their interests in Trust I. The majority quotes with approval the Appellate Division's statement that " '[a] *party* to a lawsuit cannot sit by idly while a contract, to which he is also a party, is judicially construed' " (__ N.Y.2d __, at __ [Slip Opn, at 12] [emphasis supplied]).

There are two fatal factual flaws in the foregoing reasoning, as a close examination of the pleadings and procedural history of the prior suit discloses. First, defendants were *not* parties to the *entire* prior litigation. Rhodes merely joined them as trust beneficiaries on his claim in Count I of his complaint. That cause of action related solely to alleged misconduct of plaintiffs as trustees of Trust I. In defending against Rhodes' claim in Count I, plaintiffs neither placed in issue the validity of Trust I nor defendants' status as trust beneficiaries. Then, in counterclaiming *individually* (not as trustees) against Rhodes to rescind only *his* beneficial interests in Trust I and Trust II, plaintiffs again refrained from challenging the validity of Trust I or defendants' beneficial interests in it. Had they done so, obviously, defendants would have been necessary parties to the counterclaim, requiring cross-claim joinder by plaintiffs, just as joinder had been required on Rhodes' Count I cause of action (*see*, CPLR

3019[b]; Siegel, Prac Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR 3019, at 216).

Furthermore, in the former litigation, plaintiffs themselves must have determined that defendants' nominal party status on Rhodes' Count I cause of action was insufficient to bind them conclusively to any judgment favorable to plaintiffs on their third counterclaim. Otherwise, plaintiffs would not have moved to join defendants on the counterclaim, a totally unnecessary procedure if the litigation on the counterclaim with Rhodes alone would have preclusive effect on defendants.[1] Plaintiffs, not defendants, were the parties who "s[at] by idly" through eight years of the litigation, including protracted discovery, before attempting to join defendants as parties to the counterclaim—the procedural relief necessary to give the adjudication on their counterclaim in the *Rhodes* action preclusive effect against defendants.

The majority's further conclusion, that defendants, as "parties to the *Rhodes* action with notice of the issues to be decided in that case" (__ N.Y.2d __, at __ [Slip Opn, at 12]), had a full and fair opportunity to litigate the validity of Trust I and of their rights under it, is also unsupported by the record and contrary to our collateral estoppel jurisprudence.

1. This conclusion is confirmed by plaintiffs' averments in support of their motion to join defendants on the counterclaim that "[i]f the motion is denied, *two full trials* will be required to resolve the issues herein" (emphasis supplied). This is an unmistakable concession that party preclusion could not be applied against defendants on their counterclaim, solely based upon their joinder as nominal parties on Rhodes' Count I cause of action.

Appendix A

The trial judge in the prior action denied plaintiffs' 1995 motion to amend their answer to extend their third counterclaim to defendants. That ruling, which was not appealed, was based in part on findings that the request came after "the note of issue was filed following protracted discovery," and that to grant the request would have either curtailed necessary additional discovery, or further delayed the trial of "this eight-year-old lawsuit."

New discovery would have been vital to all parties and especially defendants, if they had been joined on the counterclaim, because their affidavits herein show that they had extensive dealings with plaintiffs separate from Rhodes, both before and after his withdrawal from the law partnership. Of particular importance in this regard, defendants have averred that, independently of Rhodes, at or near the inception of the lawyer-client relationship, they advised plaintiffs of the potential conflict of interest and to seek independent counsel regarding the parties' proprietary interests/contingent fee arrangement. Indeed, the majority finds especially critical that Rhodes failed to so address plaintiffs at the time of the proposed incorporation of Biomedical Engineering Corporation (BEC) which resulted in "converting the one-third interest in a single invention into a one-third equity interest in a corporation that would exploit all future inventions" (__ N.Y.2d __, at __ [Slip Opn, at 2]). While Rhodes conceded never giving such advice, defendant Bain stated in a sworn affidavit in this action:

> "At this point and before the corporation was formed, I personally undertook to advise Buechel and Pappas that they should consult an

> independent attorney with respect to their dealings with us which now was in the nature of a business rather than legal representation alone. I did this on two separate occasions in 1974 in our law offices. On one occasion I was alone with Buechel and Pappas and on the other Gilfillan, Buechel, Pappas and I were present. On each occasion, I explained to them that there was an inherent conflict of interests in the proposed relationship. I also explained to them that they should seek independent counsel and could seek our services from other attorneys."

It would seem self-evident that, had the *Rhodes* trial court granted the motion to join defendants on plaintiffs' counterclaim and then ordered that the trial proceed expeditiously, the resultant curtailment of defendants' right to engage in discovery would have denied them a full and fair opportunity to defend the validity of their beneficial interests in Trust I. Surely, then, the total absence of participation, including the entire loss of opportunity for discovery, occasioned by the *Rhodes v. Buechel* trial court's refusal to grant plaintiffs' motion to join defendants on their counterclaim, must also be a denial of a full and fair opportunity to litigate.

The majority also disregards entirely our precedents holding that a party is denied a full and fair opportunity to litigate in a prior action when "a practical inquiry into 'the realities of litigation' " reveals that the party lacked any serious incentive to fully and vigorously participate (*Gilberg v. Barbieri*, 53 N.Y.2d 285, 292-293). Under the uncontested

facts in the record in *Rhodes v. Buechel*, defendants had every *disincentive* to fully litigate there the issue of the validity of Trust I and of their beneficial interests in it.

First, they were unwilling participants in that action, joined only as "defendant-beneficiaries" when plaintiffs moved to dismiss Rhodes' complaint for failure to join them as necessary parties. Second, it is entirely undisputed that, until the falling out between plaintiffs and defendants in 1995, leading quickly to plaintiffs' motion to amend the answer to force defendants' active trial participation on the issues raised by their counterclaim, defendants continued to furnish legal services to plaintiffs and the trust and to regularly receive from plaintiffs as trustees their fractional share of the substantial trust income. Third, defendants had no direct stake in the outcome of the *Rhodes* suit. Plaintiffs' counterclaim unequivocally sought only to invalidate Rhodes' interests in Trust I because of *his* breach of fiduciary duty.[2] Indeed, in their affirmative defenses, plaintiffs relied upon provisions

2. The counterclaim never ascribes any breach of fiduciary duty to the Rhodes/defendants partnership or lawfirm as such, only to Rhodes individually. Thus, "Rhodes knew that the agreements were unfair" (counterclaim par. 93); "Rhodes, while acting as their attorney, induced Drs. Buechel and Pappas to enter into the unfair Agreements" (*id.*, par. 94); "In breach and violation of his duties under the Agreements, and of his fiduciary duties in connection therewith, Rhodes failed fully, properly, accurately and truthfully to advise Drs. Buechel and Pappas * * *" (*id.* par. 97). Most crucially, the *ad damnum* clause of the counterclaim states: "By reason of *his* aforesaid conduct, including, without limitation, *his* overreaching while a fiduciary and *his* breach of *his* representation and warranties, *Rhodes' interests* in Trust I and Trust II should be terminated and rescinded" (counterclaim par. 107 [emphasis supplied]).

of the trust instrument and upon defendants' approval, in their capacities as trust beneficiaries, of plaintiffs' conduct as trustees. Certainly then, through the nearly eight years of litigation prior to plaintiffs' 1995 motion to amend the counterclaim, the last thing plaintiffs would have wanted was the conversion of their harmonious lawyer/client, trustee/beneficiary relationships with plaintiffs into a fully adversarial one in the *Rhodes v. Buechel* litigation.

It follows from the foregoing that here, even more than in *Staatsburg Water Co. v. Staatsburg Fire Dist.* (72 N.Y.2d 147, 154), defendants were "[a]t most * * * interested, albeit unwilling participant[s]" in the prior action. Likewise, "the lack of any direct stake in the outcome of the proceeding left defendant[s] with little incentive to fully litigate the issue" (*id.*). Thus, even if it could be argued here that defendants were "granted the opportunity to participate [in the *Rhodes* litigation], this did not necessarily amount to a full and fair opportunity to contest the determination" (*id.*).

Apparently addressing the total absence of defendants' incentive to litigate plaintiffs' counterclaim in *Rhodes v. Buechel,* the majority relies upon a January 1995 letter from defendant Bain to plaintiffs' counsel in which he questioned "whether or not we must become active in the Rhodes litigation to protect our rights" (__ N.Y.2d __, at __ [Slip Opn, at 5]). The majority implies that this letter demonstrated that defendants anticipated the preclusive effect of a judgment in plaintiffs' favor on their counterclaim. There are two short answers to that suggestion.

First, the issue raised by defendants in that letter had no relationship whatsoever to plaintiffs' counterclaim. It concerned whether, under the terms of Trust I, the legal fees paid to outside counsel in a specific foreign litigation, the "Link suit," regarding one of the trust's patents were chargeable to the lawyers/beneficiaries rather than "considered to be out-of-pocket expenses or disbursements [of the trusts]." That issue directly pertained to the kind of trustee misconduct alleged in Rhodes' Count I of the complaint, to which defendants were nominal parties. Defendants, on that issue, could very well have been apprehensive as to whether they should participate in the Count I litigation in *Rhodes v. Buechel* to protect their rights "vis-a-vis the position of the trustees regarding [outside counsel] legal fees." Plaintiffs' counterclaim, on the other hand, dealt with the entirely separate issue of Rhodes' misconduct as their attorney.

Even if the majority's implication that defendants' letter demonstrated their apprehension as to the preclusive effect of a judgment on the counterclaim in the former action is a fair one (which it is not), it would not be sufficient to establish an incentive to litigate on the part of defendants in their individual capacity in the *Rhodes v. Buechel* action. As we said in *Staatsburg Water Co.*, "it would be * * * fundamentally unfair to give preclusive effect to a determination *where the only incentive to litigate stems from its potential collateral effects*. Such a ruling would ill serve the litigation-limiting purposes of collateral estoppel" (*id.*, at 155 [emphasis supplied]).

Appendix A

Defendants' disincentive to fully litigate their rights under Trust I in the *Rhodes v. Buechel* case did not cease when hostilities between them and plaintiffs arose in 1995, followed promptly by plaintiffs' motion to amend their counterclaim in *Rhodes*. These developments occurred after protracted discovery and the filing of the note of issue, when the trial of the action was imminent. As previously discussed, to enter the litigation at that point would have entailed waiver of the opportunity to engage in full discovery, a great handicap for defendants.

Moreover, there was an even more imperative strategic reason for defendants to avoid joinder on the counterclaim in *Rhodes v. Buechel*, derived from New York's earlier abandonment of the mutuality of estoppel doctrine. Prior to *B.R. DeWitt, Inc. v. Hall* (19 N.Y2d 141), New York ostensibly adhered to the "so-called rule of mutuality of estoppel, which provided that unless both parties [to the subsequent action] are bound by the prior judgment, neither may use it" (*id.*, at 144). In *B.R. DeWitt,* however, we announced that the " 'doctrine of mutuality' is a dead letter" (*id.*, at 147) and that, henceforth, collateral estoppel could be invoked, either defensively or offensively by a nonparty to the prior litigation, providing that the requirements for collateral estoppel (identity of issues and full and fair opportunity to litigate) were met as to the party sought to be precluded (*see*, *id.*, at 148).

There being no mutuality of estoppel, defendants had everything to lose and nothing to gain from active participation in the counterclaim litigation regarding the validity of the 1974 retainer agreement and of their beneficial

interests in Trust I. Had those issues been resolved against plaintiffs on their counterclaim in *Rhodes,* defendants could have used the judgment defensively in any subsequent suit by plaintiffs, such as the instant one, to preclude plaintiffs from attacking the validity of the retainer and trust instruments. On the other hand, as nonparties to the counterclaim litigation in *Rhodes,* defendants ordinarily would not be bound by a disposition of that counterclaim favorable to plaintiffs.[3]

Refraining from active participation in the trial of the issues raised by plaintiffs' counterclaim in the *Rhodes* case, was, thus, a completely understandable and legitimate strategy for defendants. The umbrage against defendants taken by the majority and the Appellate Division for "sit[ting] idly by" in implementation of that strategy is better directed at this Court's abandonment of the mutuality of estoppel doctrine, not at defendants for taking advantage of that abandonment.

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3. Nonmutuality of estoppel, under which plaintiffs would be precluded in a subsequent litigation with defendants by an unfavorable disposition of their counterclaim in Rhodes v. Buechel, but not vice versa, as to defendants, nonparties to this counterclaim, explains their averments supporting a stay of the instant action, relied upon by the majority (*see*, __ N.Y.2d __, at __ [Slip Opn, at 5-6, 14-15]). By no means can they be construed as an awareness that defendants would be bound by a resolution of the counterclaim favorable to plaintiffs.

Appendix A

Privity

The majority's primary ground for imposing issue preclusion here is on the basis of defendants' privity with Rhodes in the *Rhodes v. Buechel* case. In adopting that theory, the majority applies a standard which is contrary to our precedents, is of highly dubious constitutionality and will create uncertainty of application destructive to the litigation-limiting purposes of collateral estoppel.

Our courts, adhering to the approach of the Restatement (Second) of Judgments (Introductory Note to Chapter 4, at 344), have identified three general categories of privity that have been applied to collaterally estop a nonparty in a subsequent suit involving the same issue. Privity will be found if the nonparty (1) "ha[s] a relationship with a party to the prior litigation such that his own rights or obligations in the subsequent proceeding are *condition[al]* * * * or *derivative* of, the rights of the party to the prior litigation" (*D'Arata v. New York State Central Mutual Fire Ins. Co.*, 76 N.Y.2d 659, 664; *see*, *Matter of Juan C. v. Cortines*, 89 N.Y.2d 659, 667); (2) controlled or substantially participated in control of the prior action (*see*, *David v. Biondo*, 92 N.Y.2d 318, 323-324; *Matter of Juan C.*, *supra*; *Watts v. Swiss Bank Corp.*, 27 N.Y.2d 270, 277-278; Restatement [Second] of Judgments § 39); or (3) had its interests *represented* by the losing party in the prior litigation (*see*, *Matter of Juan C. v. Cortines*, *supra*, at 668; Restatement [Second] of Judgments § 41). Defendants fall into none of these categories.

Appendix A

There is no tenable basis to find that defendants' rights in the instant action are conditional or derivative of Rhodes' rights in the prior litigation. In this respect, this case contrasts decisively with *D'Arata v. New York State Mutual Fire Ins. Co.* (*supra*), a quintessential derivative or conditional rights privity case. There, the injured victim of an assault asserted a claim against the liability insurance carrier of the perpetrator solely as a *subrogee* of the insured's rights under the policy. As the insured's subrogee, of course it was "subject to whatever rules of estoppel would apply to the insured" (*id.*, at 665).

At stake here, according to the relief requested in plaintiffs' complaint, are defendants' beneficial interests in Trust I. Clearly and unmistakably, plaintiffs' *Rhodes v. Buechel* counterclaim was related exclusively to Rhodes' interests in that trust. The trust agreement itself defines the interests of each beneficiary separately and distinctly from the others. Moreover, that instrument required defendants, but not Rhodes, to provide legal services with respect to enforcement or defense of the patents held in the trust. Defendants' juridical relationships and rights under the trusts were thus separate and, in some aspects, quite different from Rhodes' interests.

The fact that Rhodes and defendants were law partners when the 1974 retainer agreement was entered into does not alter the conclusion that defendants' *rights* were not conditional or derivative of those of Rhodes in the prior litigation over plaintiffs' counterclaim. As the majority points out, the original retainer agreement had been superseded and broadened twice thereafter and no longer defined the rights

of any of the parties. Furthermore, even if the retainer agreement had been in effect when plaintiffs' counterclaim was interposed, plaintiffs did not choose to assert any claim against the partnership as such or sue Rhodes in any representative capacity as a partner, and did not join or serve defendants, Rhodes' partners, as parties. Under such circumstances, the judgment against Rhodes on the counterclaim would not have had any preclusive effect regarding the personal liability of defendants (*see,* CPLR 1025; CPLR 1501; Alexander, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR C1025:1, at 257; *id.*, CPLR 1501, at 592). The fact that defendants, as law firm members, might be bound by Rhodes' conduct during the existence of the partnership would have potential relevance to the merits of this action but, as the foregoing authorities establish, not to any preclusive effect of the judgment against Rhodes on the counterclaim in which defendants were not joined as party litigants.

Nor can privity be established here because defendants controlled or substantially participated in control of Rhodes' defense to plaintiffs' counterclaim. There is not a scintilla of evidence that defendants and Rhodes shared key litigation decisions in defending against the counterclaim, such as choice of counsel, legal strategy, presentation of evidence or the order of proof. At most, they sporadically cooperated with Rhodes following plaintiffs' failed attempt to join them on the counterclaim. Even a nonparty's energetic cooperation or assistance, such as testifying as a witness in the prior suit, is insufficient to establish the requisite control (*see, David v. Biondo, supra*, 92 N.Y.2d, at 324; *see also, Bigelow v. Old Dominion Copper Mining and Smelting Co.*, 225 U.S. 111,

126, *abrogated on other grounds by Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326-333 [recognizing the abandonment of the doctrine of mutuality of estoppel]). "To have control of litigation requires that a person have effective choice as to the legal theories and proofs to be advanced [on] behalf of the party to the action. He must also have control over the opportunity to obtain review" (Restatement [Second] of Judgments § 39, comment c).

Privity likewise cannot be based on the theory that Rhodes represented defendants' interests on the counterclaim in *Rhodes v. Buechel*. Rhodes had no fiduciary or other legal obligation to act on defendants' behalf in defending against plaintiffs' counterclaim, which implicated only his own interests (*see*, Restatement [Second] of Judgments § 41[1]). Nor did Rhodes undertake or assume any *de facto* responsibility to represent defendants' interests in defending against the counterclaim (*cf., Matter of Slocum [on behalf of Nathan A.] v. Joseph B.*, 183 A.D.2d 102, 104).

The record is devoid of any evidence that Rhodes would have been motivated to protect defendants' interests, or that he did so in the prior litigation. The law partnership broke up acrimoniously in 1981. Unquestionably, from Rhodes' initiation of suit in 1987 until 1995, while defendants continued to provide legal services to plaintiffs both individually and as trustees of Trust I, the former partners' interests were antithetical. In fact, after plaintiffs' counterclaims were interposed, Rhodes threatened defendants that he would cross-claim against them. Rhodes would not have had any incentive to proffer evidence of separate lawyer-client relations between plaintiffs and defendants, proof of

which might have mitigated or negated the taint of any alleged breach of professional fiduciary duty under the 1974 retainer agreement (*see*, Bain Affidavit, *supra*).

In actuality, the majority does not rely upon any of the traditional privity grounds. The majority's theory of privity is explained instead as follows: "defendants should be deemed to be in privity with Rhodes for purposes of litigating validity of their fee arrangement as embodied in the trust [because their] * * * rights to receive payments were *coextensive* with Rhodes and derived from the identical arrangement entered into when the three were law partners," and "[d]efendants' *interests were aligned* with Rhodes with respect to the lawfulness of the fee arrangements" (__ NY2 __, at __ [Slip Opn, at 11-12]).[4]

Although the majority agrees that privity preclusion is dependent upon "whether the party sought to be bound and the party against whom the litigated issue was decided *have*

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4. The majority finds a "basic problem" with the dissent in that it does not acknowledge that "the *Rhodes* judgment rescinded Rhodes' interest in the trusts because it found that the [fee] agreements from which the interest arose were invalid" (__ N.Y.2d __, at __ [Slip Opn, at 17]). That finding, however, has no significance for preclusion purposes absent an independent establishment of privity; it does not itself demonstrate that privity exists. Thus, the majority's point begs the question.

Also irrelevant is the majority's additional reliance on a portion of the *Rhodes* court's decision which "ordered that 'the trust agreements are rescinded' " (__ N.Y.2d __, at __ [Slip Opn, at 6]). Defendants protested that ruling because plaintiffs "did not seek recission of the trusts themselves" (letter to Justice Lowe, 4/20/98), and it was removed from the final judgment.

a relationship" (*id.*, at __ [Slip Opn, at 11]), they have not identified any formal or even informal relationship which existed between Rhodes and defendants when plaintiffs' counterclaim was litigated. For the majority, it is entirely sufficient to establish privity that the rights of the losing litigant and the nonparty were coextensive, derived from the same source, and "aligned," *i.e.*, substantially identical. Notice to nonparties that their interests are to be adjudicated is not deemed necessary. Nor is the losing party required to have assumed a duty of representation.

The majority's rationale, thus, amounts to nothing more than an application of the broad-form "Virtual Representation Doctrine" which had a vogue in some Federal Circuits for a period of time (*see*, Richards, *Richards v. Jefferson County: The Supreme Court Stems the Crimson Tide of Res Judicata*, 38 Santa Clara L Rev 691, 706-710 [1998]; Johnson, *Due or Voodoo Process: Virtual Representation as a Justification for the Preclusion of a Nonparty's Claim*, 68 Tul L Rev 1303, 1318-1320 [1994]). Under the expansive version of that doctrine, "a person may be bound by a judgment even though not a party if one of the parties to the suit is *so closely aligned with his interests* as to be his virtual representative" (*Aerojet Gen. Corp. v. Askew*, 511 F.2d 710, 719, *cert denied sub nom Metropolitan Dade County v. Aerojet Gen. Corp.*, 423 U.S. 908 [emphasis added]). A leading text on Federal procedure states that "[t]he broadest form of [the virtual representation] theory would preclude relitigation of any issue that had once been *adequately tried* by a person *sharing a substantial identity of interests* with a nonparty" (18 Wright & Miller, Fed Practice and Procedure § 4457, at 494 [emphasis supplied]).

This Court should not adopt any such version of virtual representation, permitting preclusion merely because an issue "had once been adequately tried by a person sharing a substantial identity of interests with a nonparty" (*id.*). First, it plainly is inconsistent with our own precedents. In *Green v. Sante Fe Indus.* (70 N.Y.2d 244), the Court considered the preclusive effect of an action commenced in Federal court. The defendant parent corporation had utilized Delaware's "short form, freeze-out merger" procedure (*id.*, at 249) to acquire all remaining outstanding shares of its subsidiary. A member of the five-percent minority class of shareholders in the subsidiary brought the action in Federal court alleging, among other things, a breach of fiduciary duty to minority shareholders in offering them an unfairly low price for their shares. The Federal suit was ultimately dismissed. The action in *Green* was commenced in our State courts by other shareholders of the same minority class seeking to attack the same transaction. It was undisputed in *Green* that the minority shareholder plaintiffs in the Federal suit had "made claims *identical in legal theory* to those plaintiffs assert here" (*id.*, at 252 [emphasis supplied]). Additionally, the same counsel represented the complaining minority shareholders in each action. In *Green*, our Court rejected the application of privity to preclude the shareholders who were not parties to the Federal suit and instead decided the case on the merits.

Green v. Sante Fe Industries is virtually indistinguishable from the instant case with respect to the criteria relied upon by the majority to find privity here. In *Green*, the rights of the minority stockholders who sued in Federal court and those who sued in New York Supreme Court were truly coextensive. Plaintiffs in both suits were members of the

same class of minority shareholders; their shares of corporate stock were identical choses in action; their theory of recovery was identical, as was their legal representation. The causes of action asserted in the Federal and State courts arose out of the identical transaction — the use of the Delaware short form freeze-out merger procedure to eliminate their minority interests. We soundly rejected privity in *Green*. The Federal plaintiffs had not purported in any way to represent the State plaintiffs, nor had the Federal court in any way undertaken adjudication of the latter's interests. The rejection of privity in *Green* should be *a fortiori* controlling here.

The broad virtual representation standard for privity applied by the majority is based solely on coextensiveness (*i.e.*, substantial identity) and alignment of the interests of the parties in the successive litigations, and offends traditional notions of due process guaranteeing that parties must have their day in court before their rights are adjudicated (*see*, Johnson, 68 Tul L Rev, *supra*, at 1323-1325).

That is why the Federal courts subsequently retreated from applying a broad virtual representation doctrine, holding that it would "transgress the bounds of due process" to base privity solely on the identity of party and nonparty interests, legal positions or the need to prove the same set of facts (*Hardy v. Johns-Manville Sales Corp.*, 681 F.2d 334, 340 [5th Cir]). Those courts that previously applied only the foregoing virtual representation criteria for privity purposes now further require "the existence of an express or implied legal relationship in which parties to the first suit *are accountable* to nonparties who file a subsequent suit raising identical issues" (*Pollard v. Cockrell*, 578 F.2d 1002, 1008

[5th Cir] [emphasis supplied]; *see*, *Hardy v. Johns-Manville Sales Corp.*, *supra*, at 340).

Richards v. Jefferson County (517 U.S. 793, 796) also represents a rejection of privity-preclusion as violative of due process when it is based solely on the fact that the party's and nonparty's "respective interests [in the successive litigations] were 'essentially identical.' " The factors which the Court weighed in *Richards* were, first, that the parties to the prior suit never gave the petitioners (the plaintiffs in the suit before the Supreme Court) notice that the earlier case "would conclusively resolve their legal rights" (*id.*, at 799). Second, and even more crucial, the plaintiffs in the first suit "did not sue on behalf of a class; their pleadings did not purport to assert any claim against or on behalf of any nonparties; and the judgment they received did not purport to bind any * * * nonparties" (*id.*, at 801). Thus, the Supreme Court concluded, the nonparties to the prior litigation were not represented adequately there to meet the requirements of due process, despite the identity of their interests and those of the plaintiffs in the first action.

Defendants here fall squarely under the factors relied upon in *Richards* to find a due process violation. Never were they put on notice that their interests in Trust I would be adjudicated in the resolution of plaintiffs' counterclaim in *Rhodes v. Buechel.* Indeed, the denial of plaintiffs' motion to add them as parties in the counterclaim litigation sent the diametrically opposite message.[5] Moreover, nowhere in the

5. The concerns expressed by defendants to plaintiffs' counsel in response to Rhodes' threats to cross-claim for contribution — *i.e.*,

(Cont'd)

record is there any indication that, in defending against the counterclaim in that action, Rhodes purported to represent defendants' interests.

Thus, as in *Richards,* there was no full and fair consideration of defendants' individual interests in the *Rhodes v. Buechel* case. That is because, especially after the trial court rejected plaintiffs' motion to join defendants on their counterclaim, "there is no reason to suppose that [the *Rhodes* court] took care to protect the interests of [defendants], * * * [n]or is there any reason to suppose that * * * [Rhodes] understood [his] suit to be on behalf of [defendants]. Thus, to contend that * * * [Rhodes] somehow represented [defendants], let alone in a constitutionally adequate manner, would be 'to attribute to [him] a power that it cannot be said that [he] had assumed to exercise' " (*id.*, at 802).

Finally, in addition to its unconstitutional application here, the broad "coextensive rights" standard announced in this case to find privity will inevitably inject elements of insecurity and uncertainty for nonparties who may be substantially interested in the issues in litigation to which the parties chose not to join them. Res judicata and collateral estoppel, because of their harsh results, however, are areas

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(Cont'd)

that defendants were unclear whether the counterclaims could be interpreted as asserting claims against the former partners' *lawfirm* — cannot be construed as an acknowledgment of the preclusive effect of the counterclaim litigation against defendants in their *individual* capacity. No cross claim was ever interposed against defendants either as Rhodes' partners or individually.

crying out for foreseeability and predictability. To avoid the risk of preclusion, interested nonparties will be forced to intervene in litigation to protect their rights. The imperative to intervene flowing from the majority's privity standard stands on its head the traditional rule "put[ting] the burden of joinder on the person who wishes to obtain the benefits of the rules of preclusion, requiring him to bring in third parties involved in the transaction. Hence, as between a silent bystander and the party to prior litigation, the latter properly bears the risk that the original litigation will not terminate the controversy" (Restatement [Second] of Judgments § 62, comment a; *see also*, *Chase Manhattan National Bank v. Norwalk*, 291 U.S. 431, 441 [Brandeis, J.]; Johnson, 68 Tul L Rev, *supra,* at 1314-1315).

In presumptively forcing formal early intervention by an interested nonparty in pending litigation, the majority's privity rule "[will] ill-serve litigation-limiting purposes of collateral estoppel; it would simply encourage over litigation at an earlier stage" (*Staatsburg Water Co. v. Staatsburg Fire Dist.*, *supra*, 72 N.Y.2d, at 155). Therefore, I would vote to reverse and remit for trial on all issues.

* *

Order affirmed, with costs, and certified question answered in the affirmative. Opinion by Judge Smith. Chief Judge Kaye and Judges Ciparick, Wesley, Rosenblatt and Graffeo concur. Judge Levine dissents and votes to reverse in an opinion.

Decided December 20, 2001

APPENDIX B — DECISION OF THE SUPREME COURT, APPELLATE DIVISION, STATE OF NEW YORK DATED SEPTEMBER 28, 2000

SUPREME COURT, APPELLATE DIVISION
First Department, June 2000

Betty Weinberg Ellerin J.P.
Israel Rubin
David B. Saxe
John T. Buckley, JJ.

1567-1568

Frederick F. Buechel, M.D., et al.,

Plaintiffs-Respondents,

-against-

John N. Bain, et al.,

Defendants-Appellants,

-and-

Carella, Byrne, Bain, Gilfillan,
Cecchi, Stewart & Olstein,

Defendant,

Appendix B

-and-

R. Gale Rhodes, Jr., et al.,

Defendants-Beneficiaries.

Defendants John N. Bain and John G. Gilfillan, III, appeal from an order of the Supreme Court, New York County (Richard Lowe, III, J.), entered January 19, 2000, which denied their motion to dismiss the amended complaint, and order, same court and Justice, entered February 4, 2000, which granted plaintiffs' motion for partial summary judgment and denied defendants' cross motion.

RUBIN, J.

This matter involves the propriety of an agreement to compensate defendants for legal services rendered to plaintiffs Frederick F. Buechel, M.D. and Michael J. Pappas, Ph.D. in connection with the patenting of certain prosthetic devices plaintiffs had developed. At issue is the preclusive effect to be given to a decision rendered in a lawsuit brought by R. Gale Rhodes, Jr., a former law partner of defendants John N. Bain and John G. Gilfillan, III, in which the same Court (Richard Lowe, III, J.) ruled that the fee agreement was improper and limited the amount due Rhodes to the value of the services he had rendered to the two inventors (*Rhodes v. Buechel,* Sup Ct, NY County, April 30, 1998, index No. 8055/87). This Court affirmed the judgment, finding that "neither the initial arrangement nor its subsequent incarnations were entered into upon adequate disclosure to defendants [plaintiffs herein] of other possible fee arrangements and potential conflicts of interest, or with the

aid of independent counsel retained for the purpose of safeguarding [their] interests. Rescission of the parties' arrangements *ab initio*, with payment to [Rhodes] in quantum meruit for his services, is an equitable result (*see*, *Howard v Murray*, 43 NY2d 417, 421; *Matter of Cooperman*, 83 NY2d 465, 473; *Schlanger v. Flaton,* 218 AD2d 597, *lv. denied* 87 NY2d 812)" (*Rhodes v. Buechel*, 258 A.D.2d 274, 275). No further appeal was taken from this order.

In the present action, in which plaintiffs seek to terminate any interest defendants might have in a certain trust, defendant attorneys raise contentions that were not advanced by their former partner. First, they note that the fee arrangement found to be void in *Rhodes v Buechel* (*supra*) is specifically permitted by a Federal regulation (37 CFR § 10.64). Second, they argue that the Federal courts have exclusive jurisdiction over this issue, which they construe as a matter of patent law, and that the *Rhodes* decision is therefore void for lack of subject matter jurisdiction.

The essential facts are not in dispute. Plaintiff Buechel, a resident in orthopedic surgery, and plaintiff Pappas, a mechanical engineer, developed a prosthetic shoulder device (the floating center prosthetic joint) which they sought to protect with a patent. They retained the firm of Bain, Gilfillan & Rhodes, PC "to undertake the preparation and prosecution of a patent application covering the invention on a contingency basis." The subject fee agreement entered into by the two inventors on September 12, 1974 provides that the law firm will contribute capital to finance research and marketing of the device and that "any or all monies, profits or other income or benefits received, whether by way of

royalties or otherwise, shall be shared proportionately between the parties hereto on a one-third (1/3) basis".

The gravamen of the dispute is the extent of the disclosure made by the members of the law firm concerning the potential conflict of interest arising from the attorneys' stake in the devices they had undertaken to protect against infringement. Affidavits submitted, respectively, by defendants Bain and Gilfillan state that, on the suggestion of their former partner, R. Gale Rhodes, the parties subsequently agreed to form a corporation, both for tax considerations and to insulate the entrepreneurs from personal liability. With respect to the propriety of the fee agreement, it is averred that, preliminary to the formation of the corporation, defendant Bain specifically advised plaintiffs of the potential conflict of interest inherent in the arrangement. It is further alleged that the plaintiffs were advised to obtain independent counsel, but elected not to do so. Plaintiffs Buechel and Pappas, however, take the position that at no time were they were advised either of the potential conflict of interest or of their right to discharge the firm as their counsel at any time.

Biomedical Engineering Corporation was incorporated in New Jersey on July 16, 1975. The corporation took title to the prosthetic shoulder device and to other prosthetic devices developed by plaintiffs in the interim. In accordance with the fee agreement, Buechel and Pappas each held one-third of the shares of the corporation, while the remaining one-third interest was divided equally among the three attorneys. A dispute subsequently arose among the law partners, culminating in the departure of Rhodes in December

1981. Bain and Gilfillan continued to perform legal work for plaintiffs, and their responsibilities were expanded to include litigation and patent maintenance. Gilfillan alleges, however, that following his departure from the firm, Rhodes covertly formed a corporation in Florida with plaintiffs, also known as Biomedical Engineering Corporation, to hold any future patents Buechel and Pappas might obtain.

In late 1982 or early 1983, an attorney named John Power was retained by plaintiffs to assess the feasibility of dissolving the original Biomedical Engineering Corporation. The decision was made to dissolve the New Jersey corporation and transfer its assets to a newly formed entity, the Biomedical Engineering Trust (Trust I), with Pappas and Buechel as trustees. The shareholders of the dissolved corporation, including the three attorneys, received equivalent equity interests in the trust, which thereupon received royalty payments from the sale of some of the prosthetic devices. At the trial in *Rhodes v Buechel* (*supra*), John Power testified to conversations with Buechel and Pappas, in which he "told them what they already knew * * * that they had to rely upon the advice of the attorney partner of theirs who possibly might have a financial disincentive to give them advice that perhaps they should be receiving."

In 1984, a second trust was formed, again with Pappas and Buechel as trustees, designated the Biomedical Engineering Trust II (Trust II), which held the marketing rights to a self-centering hip device. While neither defendant held any interest in Trust II, their former partner, R. Gale Rhodes, undertook to provide legal patent protection services to this entity. In 1987, a dispute arose over trust distributions,

and Rhodes commenced his action against Buechel and Pappas to recover millions of dollars which the trustees were alleged to have improperly paid to themselves (*Rhodes v Buechel, supra*). The ensuing judgment duly recites that his former partners, Bain and Gilfillan, were joined as defendants in their capacity as trust beneficiaries and that they were represented by counsel in the *Rhodes* action.

Four years after Rhodes commenced the action, Buechel and Pappas asserted counterclaims for breach of fiduciary duty and malpractice, asserting that Rhodes had acted in violation of his ethical responsibilities as a lawyer. They did not, at that time, assert any claims against Bain and Gilfillan, who apparently continued to provide legal services to Trust I. It was not until 1995 that Buechel and Pappas sought to expand their counterclaims to seek relief against Bain and Gilfillan. Supreme Court denied their motion to amend the counterclaims, noting that the attorneys had been counterclaim defendants for seven years and that Buechel and Pappas had brought their motion to amend some five months after the filing of a note of issue, following protracted discovery and without the proffer of any excuse for the delay.

Pappas and Buechel commenced the instant action in March 1995, naming Bain and Gilfillan as defendants. The complaint contains five causes of action, alleging breach of fiduciary and ethical obligations and legal malpractice. This action, which seeks termination of trust payments to Bain and Gilfillan and turnover of Trust files maintained by the attorneys, was stayed by Supreme Court pending resolution of the *Rhodes* matter.

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The *Rhodes* litigation produced over 5,000 pages of trial transcript and resulted in a 42-page decision, invalidating the fee arrangement between plaintiffs and their original counsel, the firm of Bain, Gilfillan & Rhodes. As Supreme Court's opinion states at the inception, the complaint was brought against Buechel and Pappas, both individually and as trustees of the two Biomedical Engineering Trusts. It charged them with making improper payments to themselves from the trusts and ought to remove them as trustees and compel payment to Rhodes of his share of trust income alleged to have been withheld since 1987. However, Supreme Court found that the fee agreement from which Rhodes derived his interest in the trusts was unethical. The judgment recites the court's finding that the complaint's allegation of a breach of fiduciary duty by the trustees was without merit and, in any event, rendered moot by the rescission, *ab initio,* of any interest Rhodes might have acquired in either Trust I or Trust II under the fee agreement. The court found that plaintiffs were never advised to seek independent counsel before entering into a business relationship with their attorneys and that Rhodes had "exploited his clients through affirmatively pursuing a business relationship with them absent full disclosure" (DR 5-104[A]).

On this appeal, the parties dispute whether or not Bain and Gilfillan, who portray themselves as merely nominal parties in the unsuccessful suit by their former partner, were afforded a full and fair opportunity to litigate the question of the propriety of the fee arrangement in the *Rhodes* action. Specifically, the attorneys regard as dispositive the denial of the motion by Buechel and Pappas (plaintiffs herein) to

amend their counterclaims of breach of fiduciary duty and malpractice in *Rhodes* to include Bain and Gilfillan. Defendant attorneys note that the fee arrangement in question is "*expressly permitted under federal law* governing the conduct of federal patent practitioners" (citing 37 CFR § 10.64 [emphasis in original]), which "permits patent attorneys to take an interest in a patent in lieu of a fee." Furthermore, they argue that the determination in *Rhodes* that "the parties' fee agreement was void *ab initio* because it violated New York ethics rules" is without effect on the ground that "federal courts have exclusive jurisdiction over all claims arising under federal patent law."

Plaintiffs Pappas and Buechel claim that the jurisdiction of the Federal courts is not exclusive; that Bain and Gilfillan's respective interests in Trust I did not survive their discharge as attorneys in January 1995; that Bain and Gilfillan failed to disclose fully the options available to the inventors in retaining them as attorneys; that Bain's and Gilfillan's violation of the Canons of Ethics warranted return of the legal fees paid to them less the value of services actually rendered; and that Bain and Gilfillan had a full and fair opportunity to litigate all issues in the course of the *Rhodes* litigation.

As the parties frame it, the issue presented on this appeal is whether defendant attorneys have had their day in court so as to invoke the principle of collateral estoppel on the question of the validity of the fee agreement and, consequently, the validity of their respective interests in Trust I. This formulation suggests that the judgment rendered in *Rhodes* determines the extent of the inventors' obligation

to defendants' former partner under the fee agreement. It is the attorneys' position that, because their involvement in the *Rhodes* action was merely that of nominal defendants, they did not contest the validity of the fee agreement or otherwise actively participate in the litigation. Therefore, they argue, they should now be granted the opportunity to be heard with respect to the contract dispute and to advance their theory that Federal law is controlling.

The parties misapprehend the nature of the adjudication rendered in the *Rhodes* matter, the role of defendants in that litigation and, therefore, the application of the doctrines of res judicata and collateral estoppel. The Court of Appeals explained the distinction in *Ryan v New York Tel. Co.*, (62 NY2d 494, 500):

> This rule of res judicata is founded upon the belief that " 'it is for the interest of the community that a limit should be prescribed to litigation, and that the same cause of action ought not to be brought twice to a final determination. Justice requires that every cause be once fairly and impartially tried; but the public tranquillity demands that, having been once so tried, all litigation of that question, and between those parties, should be closed forever.' " (*Fish v Vanderlip*, 218 NY 29, 36-37, quoting Greenleaf's Evidence, §§ 522, 523; *see also*, *Schuylkill Fuel Corp. v Nieberg Realty Corp.*, 250 NY 304; *Hendrick v Biggar*, 209 NY 440.)

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> The doctrine of collateral estoppel, a narrower species of res judicata, precludes a party from relitigating in a subsequent action or proceeding an issue clearly raised in a prior action or proceeding and decided against that party or those in privity, whether or not the tribunals or causes of action are the same. (*Ripley v Storer*, 309 NY 506, 517; *see, also*, Restatement, Judgments 2d, § 27; 46 Am Jur 2d, Judgments, § 415; 9 Carmody-Wait 2d, NY Prac., Judgments, § 63:205.)

What the parties overlook is that the decision in *Rhodes* is not simply a determination of the extent of the contractual obligation undertaken by Buechel and Pappas under the fee agreement. Rather it is an adjudication of their obligation *as trustees* to make payment under the terms of Trust I, of which defendants herein and Rhodes are all beneficiaries, and Trust II, which concerns only Rhodes (*see*, *Levine v Gross*, 177 AD2d 290, 291- 292). The issue presented for decision in *Rhodes* was whether or not Buechel and Pappas, as trustees, were required to make payments to an attorney whose rights *as a trust beneficiary* derived from the fee agreement between Buechel and Pappas, individually, and the law firm of Bain, Gilfillan & Rhodes. This action similarly addresses the status of attorney-beneficiaries whose rights to receive proceeds from the trust are predicated on the identical fee agreement. Therefore, Bain and Gilfillan, who were parties to the *Rhodes* case, are barred by the doctrine of res judicata from relitigating the question of their entitlement to trust proceeds. That defendant attorneys did not participate actively in the *Rhodes* action is immaterial, as is their failure

to raise the preemption issue or their own measures to comply with the Canons of Ethics. As this Court observed in *Boorman v Deutsch*, 152 AD2d 48, 53, *appeal dismissed* 76 NY2d 889, "res judicata embraces not only those matters which are actually litigated before a court but also those relevant issues which could have been litigated (*Schuylkill Fuel Corp. v Nieberg Realty Corp.*, 250 NY 304), including jurisdiction (*Angel v Bullington,* 330 US 183; *Johnson v Muelberger,* 340 US 581; *Reich v. Cochran*, 151 NY 122."

The contention that Bain and Gilfillan were merely nominal parties to the *Rhodes* matter is without merit. The parties' freedom to chart their own procedural course before the courts is not without limits (*Stevenson v News Syndicate Co.,* 302 NY 81, 87; *Matter of Malloy,* 278 NY 429). CPLR 1001(a) provides, "Persons who ought to be parties if complete relief is to be accorded between the persons who are parties to the action or who might be inequitably affected by a judgment in the action shall be made plaintiffs or defendants." It further provides: "When a person who should join as a plaintiff refuses to do so, he may be made a defendant."

The beneficiary of a trust has no legal estate in trust property but has only the equitable power of enforcement (EPTL § 7-2.1 [a]; *Duvall v English Evangelical Lutheran Church*, 53 NY 500 [1873]). Where the extent of the duty of the trustees to disburse trust income is raised by one of its beneficiaries, the resulting judgment will necessarily affect the concomitant right of other beneficiaries, similarly situated, to receive such payments. They are therefore not merely incidental but essential parties to the action, subject

to joinder under CPLR 1001(a). The purpose of the compulsory joinder rule is both to prevent duplicative litigation and to protect the rights of persons who may be adversely affected by the outcome (*see*, *Manufacturers Hanover Trust Co. v Crossland Sav.*, 177 AD2d 78, 79, 82; *Parker v 151 East 83rd Street Tenants Corp.*, 171 AD2d 599; 3 Weinstein-Korn-Miller, N.Y. Civ. Prac. ¶ 1001 .01). Having been joined as parties to the *Rhodes* action for the purpose of permitting them to protect their interests as beneficiaries of Trust I, Bain and Gilfillan cannot complain that they failed to avail themselves of the opportunity presented. They certainly may not require the courts to entertain an issue that could have been decided in the *Rhodes* action had it been timely raised. Apart from avoiding the imposition on limited judicial resources (*see*, *Smith v Daca Taxi*, 222 AD2d 209, 211 [vacatur]; *Rabov v McCrory Corp.*, 210 AD2d 145, 147 [consolidation]), the bar against duplicative litigation obviates the potential for "conflicting rulings on identical issues" (*Bank of Tokyo-Mitsubishi, Ltd. v Kvaerner a.s.*, 243 AD2d 1, 9). The judgment rendered in *Rhodes* decides not only the propriety of the conduct of the trustees, but also the validity of the agreement under which the attorney-beneficiaries, as partners in a law firm, derived their interest in the trusts. No appeal was taken from this Court's affirmance of the judgment in that case, and the outcome is conclusive of the issues sought to be raised by defendants in this matter.

Application of the doctrine of collateral estoppel, as urged by defendants, does not alter the disposition. In applying the doctrine, "the fundamental inquiry is whether relitigation should be permitted in a particular case in light

of what are often competing policy considerations, including fairness to the parties, conservation of the resources of the court and the litigants, and the societal interests in consistent and accurate results" (*Staatsburg Water Co. v Staatsburg Fire Dist.*, 72 NY2d 147, 153). To be estopped, the party to the present litigation must either have been a party to the prior proceeding or in privity with a party to that proceeding (*D'Arata v New York Cent. Mut. Fire Ins. Co.*, 76 NY2d 659, 664). Under the concept of privity, collateral estoppel has been said to extend to "those whose interests are represented by a party to the action" (*Watts v Swiss Bank Corp.*, 27 NY2d 270, 277, citing Restatement of Judgments §§ 81-90).

As this Court recently noted in *All Terrain Props. v Hoy*, 265 AD2d 87, 93:

> Privity has been described as "an amorphous term not susceptible to ease of application" (*Gramatan Home Investors Corp. v. Lopez*, 46 NY2d 481, 486). The doctrine extends to "persons who were not parties to the previous action but who were connected with it to such an extent that they are treated as if they were parties" (*id.*). "What is controlling is the identity of the issue which has necessarily been decided in the prior action or proceeding" (*Ryan v. New York Tel. Co., supra*, 62 NY2d 494, 500).

Privity clearly extends to the partners comprising the law firm that is party to the subject contract, and Supreme Court's assessment of the validity of the fee agreement before it in

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Rhodes was essential to its determination that the trustees have no obligation to make any payments to a beneficiary who derives his interest from that agreement. Irrespective of their capacity in the *Rhodes* litigation, whether as essential or merely nominal parties, Bain and Gilfillan are clearly in privity with Rhodes. As partners in the law firm that entered into the fee agreement with plaintiffs, their right to receive trust income stands or falls with the contract. The three attorneys are united in interest with respect to the enforcement of the agreement and are therefore estopped from relitigating its validity, an identical issue necessarily decided in the prior action (*id.*).

Defendant Bain additionally asserts that "there was simply no basis to apply New York's code of ethics to an agreement entered into in New Jersey between federal patent practitioners resident in New Jersey and their New Jersey clients involving conduct governed — and expressly sanctioned — by federal patent law." The question of what state's law should be applied to the obligation of the trustees to make payments to the attorney beneficiaries, likewise, could have been raised in the context of the *Rhodes* litigation, but was not. A party to a lawsuit cannot sit by idly while a contract, to which he is also a party, is judicially construed without being precluded by the result. Implicit in a court's entry of judgment is a determination of its power to render it and, similarly, the preemption of State law was an issue necessarily resolved in *Rhodes* with preclusive effect against the parties and their privies.

Were this Court to reach the arguments sought to be advanced by defendants herein, it would find them to be

without merit. That a Federal regulation (37 CFR 10.64) permits an attorney to take an interest in a patent in lieu of a fee for services rendered is not dispositive of either the validity of defendants' conduct nor the jurisdiction of the courts of this State. As 37 CFR 10.1 of the regulations provides, "Nothing in this part shall be construed to preempt the authority of each State to regulate the practice of law, except to the extent necessary for the Patent and Trademark Office to accomplish its federal objectives". While the patent regulations are pertinent with respect to the interest bestowed on the attorneys by the inventor-clients, the regulations do not obviate the full disclosure required by the Canons of Ethics governing the practice of law in this State. Consequently, the propriety of the fee arrangement at issue in this case is not a question that arises exclusively under patent law, and Supreme Court had subject matter jurisdiction to rescind the fee agreement upon the finding that it was made without the necessary disclosure of the potential conflict of interest and without the advice of independent counsel.

Accordingly, the order of Supreme Court, New York County (Richard Lowe, III, J.), entered January 19, 2000, which denied defendants' motion to dismiss the amended complaint, should be affirmed, without costs. Order, same court and Justice, entered February 4, 2000, which granted plaintiffs' motion for partial summary judgment and denied defendants' cross motion for summary judgment, should be affirmed, without costs.

All concur.

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THIS CONSTITUTES THE DECISION AND ORDER OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: SEPTEMBER 28, 2000

s/ Catherine [illegible] Wolfe
CLERK

APPENDIX C — ORDER OF THE SUPREME COURT, COUNTY OF NEW YORK, STATE OF NEW YORK FILED FEBRUARY 4, 2000

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 22

PRESENT:

Hon. Richard B. Lowe, III

Index No. 106963/95

FREDERICK F. BUECHEL, M.D. and MICHAEL J. PAPPAS, Ph.D., individually and as Trustees of certain trusts entitled Biomedical Engineering Trust,

Plaintiffs,

-against-

JOHN N. BAIN, JOHN G. GILFILLAN, III and CARELLA, BYRNE, BAIN, GILFILLAN, CECCHI, STEWART & OLSTEIN,

Defendants,

-and-

R. GALE RHODES, JR. and PAUL A. WITTE, as beneficiaries of a certain trust entitled BIOMEDICAL ENGINEERING TRUST,

Defendant-Beneficiaries.

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ORDER

Plaintiffs, Frederick F. Buechel and Michael J. Pappas having moved far partial summary judgment pursuant to CPLR Section 3212, and defendants John N. Bain and John G. Gilfillan, III, and Carella, Byrne, Bain, Gilfillan, Cecchi, Stewart & Olstein, having cross-moved for partial summary judgment pursuant to CPLR Section 3212, and such motions having regularly come to be heard on the 19th day of January, 1999;

Now, upon reading and filing plaintiffs' Complaint, dated March 21, 1995 (the "Complaint"), plaintiff's notice of motion, dated July 27, 1998, the affidavits of Arnold Weiss, Esq., sworn to, respectively, February 10, 1995, July 24, 1998 and February 19, 1999, the affidavit of David N. Ellenhorn, Esq., sworn to November 18, 1998, the affidavit of Michael J. Pappas, sworn to February 10, 1995, and the exhibits annexed thereto, in support of plaintiffs' motion for partial summary judgment and in opposition to defendants' cross motion for partial summary judgment, and defendants' notice of cross-motion, dated September 18, 1998, the affidavits of John N. Bain, sworn to, respectively, October 2, 1998, December 11, 1998, February 8, 1999 and March 2, 1999, the affidavits of John G. Gilfillan, III, sworn to, respectively, September 18, 1998, December 11, 1998, February 8, 1999 and February 26, 1999, the affidavits of Lorna McKenzie, Esq., sworn to, respectively, September 17, 1998 and December 11, 1998, and the exhibits annexed thereto, in opposition to plaintiffs' motion for partial summary judgment and in support of defendants' cross-motion for partial summary judgment, and due deliberation having been had and the Court having rendered its written decision, dated May 26, 1999,

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NOW, upon motion of Power, Weiss & Kurnit, LLP and Solomon, Zauderer, Ellenhorn, Frischer & Sharp, attorneys for plaintiffs, it is

ORDERED, that plaintiffs' motion for partial summary judgment on the First, Second and Third Causes of Action in the Complaint (which assert the same claims as the First, Second, and Third Causes of Action in the Amended Complaint, dated April 12, 1999 (the "Amended Complaint")) is granted in its entirety and the interests of defendants Bain and Gilfillan in the Biomedical Engineering Trust ("Trust I") are hereby rescinded and terminated ab initio, and it is further

ORDERED, that the fee agreements, whether in the form of a trust, corporate entity, partnership and/or contingent fee agreement, between plaintiffs and defendants Bain and Gilfillan, are unenforceable and rescinded ab initio because they were entered into in violation of the ethical duties owed to plaintiffs, and it is further

ORDERED, that defendants' motion for partial summary judgment is granted to the limited extent that two claims in the Fourth Cause of Action of the Complaint alleging malpractice with respect to inventions that are the subject matter of U.S. Patent Nos. 4,619,658 and 3,916,451 are dismissed with prejudice, but the claim in the Fourth Cause of Action of the Complaint alleging malpractice concerning the invention entitled the "Floating Rotating Platform Bearing," (which alleges the same claims as the Fourth Cause of Action of the Amended Complaint) which was not the subject of defendants' cross motion, is not dismissed, and is severed, and it is further

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ORDERED, that Bain and Gilfillan are jointly and severally liable to return to plaintiffs the total amount of compensation they received from Trust 1, or its predecessors, as well as interest, accruing from the date of each payment to Bain and Gilfillan through entry of judgment, and costs and disbursements, less the quantum meruit value of the legal services provided by Bain and Gilfillan in an amount to be determined by the Court, appropriate accrued interest to be also applied thereto, and it is further

ORDERED, that the issues of the precise aggregate fees received by the attorneys plus accrued interest and the quantum meruit value of their legal service are referred to a Special Referee to hear and report (with recommendations), the parties to submit affidavits and supporting documentation on each issue by the first hearing date together with requests for any disclosure that may still be required, and it is further

ORDERED, that the motion are held in abeyance pending receipt of the report and recommendations of the Special Referee [Judicial Hearing Officer] and a motion pursuant to CPLR 4403, and it is further

ORDERED, that a copy of this order with notice of entry shall be served on the Legal Support Office (Room 311) to arrange a date for the reference to a Special Referee [Judicial Hearing Officer].

ENTER:

J.S.C.

APPENDIX D — ORDER OF THE SUPREME COURT, COUNTY OF NEW YORK, STATE OF NEW YORK FILED JANUARY 19, 2000

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 22

INDEX No:106963/95

FREDERICK F. BUECHEL, M.D. and MICHAEL J. PAPPAS, PhD., individually and as Trustees of certain trusts entitled Biomedical Engineering Trust,

Plaintiffs,

- against -

JOHN N. BAIN, JOHN G. GILFILLAN, III, and CARELLA, BYRNE, BAIN, GILFILLAN, CECCHI, STEWART & OLSTEIN,

Defendants,

- and -

R. GALE RHODES, JR. and PAUL A. WITTE, as beneficiaries of a certain trust entitled BIOMEDICAL ENGINEERING TRUST,

Defendant-Beneficiaries.

Appendix D

RICHARD B. LOWE, III, J.:

Motions Nos. 8 and 9 and the calendar of October 14, 1999 are consolidated for disposition.

The individual defendants, patent attorneys, move by separate applications to dismiss the amended complaint sounding in legal malpractice and recission of their long term fee arrangement with plaintiffs, as pre-empted by Federal Patent Law, or in the alternative, to stay this action pending a ruling by the federal courts on the substantive issues raised herein. Defendants also seek to vacate this court's order dated February 8, 1999, enjoining defendants from having recourse to "any (other) court to adjudicate the merits of any substantive claim at issue in the instant matter . . . ," and related procedural relief. Defendants' motion and cross-motion are disposed of as follows.

Firstly, there is no merit to the defendants' contention that "plaintiffs' exclusive remedy for alleged violation of federal patent laws lies in the federal courts." The interpretation of the patent law on issues of patent priority and infringement are hardly at issue in this action. Nor have defendants made any showing to support their contention that the issues of professional ethics central to this litigation fall under the exclusive jurisdiction of the Patent Trademark Office (PTO Code) enacted to guide the performance of patent and trademark attorneys. Rather, the holdings cited to support this novel thesis merely stand as authority for the general principle that state courts may not abridge rights accorded to patent attorneys under the ethical code applicable to their legal specialty. To prevail on

this point defendants would have to establish that plaintiffs' successful allegation in their first, second and third causes of action (i.e. that defendants were lacking candor as to the potential consequences of certain profit-sharing agreements) violated rights acquired by the patent attorneys under the PTO Code. No serious effort has been made in this regard nor with respect to the single malpractice claim now pleaded in the fourth cause of the amended complaint (cf. Sperry v. Florida. 373 US 379, 396, 397; Silverman v. State Bar of Texas, 405 F2d 410, 413).

Equally untenable is defendants' argument that this court's decision of May 26, 1999 (entered June 1, 1999) is invalid because plaintiffs served an amended complaint on June 2, 1999 alleging the identical recission claims originally pleaded and repleaded a revised fourth cause of action for legal malpractice omitting two of the three patent matters concededly time-barred patent application claims specified in the original complaint. While defendant correctly invoke a principal of law generally applicable in this area, i.e., that "orderly procedure contemplates that a defendant be afforded an opportunity to answer an amended complaint," (Inland Credit Corp. v. Blvds, 27 AD2d 928), this salutary procedural rule does not rigidly apply without exception regardless of the circumstances of a given case. Even assuming the amended complaint technically superseded the original complaint before the decision granting recession on res judicata grounds was rendered, the court was not thereby bound to await the formal service of a predictably repetitive answer before ruling on plaintiffs' recission claims. Defendants submitted comprehensive affidavits in response to plaintiffs' motion for summary judgment, thereby obviating the need for the court to await

service of a formal answer. The parties having charted their own procedural course, defendants may not now rightly urge that summary disposition of the recession claims be recalendered. (*See*, *Huggins v. Whitney*, 239 AD2d 174).

Parenthetically, the court wishes to clarify its May 26, 1999 decision insofar as it inadvertently dismissed the entire original fourth cause of action as time-barred. The court intended to dismiss only the two patent applications referred to on Page "5" of the decision that were addressed in defendant's cross-motion to dismiss and overlooked the more current "Bahlen patent malpractice claims" that were never challenged by the defendants. The May 26, 1999 decision is so amended while the main motion and cross-motion are denied insofar as they seek to dismiss the amended complaint or obtain a stay of further proceedings.

Finally, the branch of defendant's applications seeking, in effect, reconsideration of the order of February 8, 1999 is granted relieving defendants of the injunctive relief awarded in that order. In the court's view barring defendants from recourse to the federal courts in connection with the already resolved recission claims would tend to further the need for "the harmonious cooperation of federal and state tribunals," emphasized in *Princess Lida v. Thompson*, 305 U.S. 456, 466. Nevertheless, it has been clearly decided in a later Supreme Court decision that a defeated party in state court litigation may still raise before a federal court issues already decided against him, regardless of the likelihood of the issuance of an additional adverse decision under the doctrine of res judicata (*See*, *Donovan v. City of Dallas*, 377 U.S. 408, 412).

Appendix D

This shall constitute the decision and order of the court.

Dated: January , 2000

s/ Richard B. Lowe III
Judge Richard B. Lowe III
J.S.C.

APPENDIX E — MEMORANDUM DECISION OF THE SUPREME COURT, COUNTY OF NEW YORK, STATE OF NEW YORK FILED MAY 26, 1999

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 22

INDEX NO:106963/95

FREDERICK F. BUECHEL, M.D. and MICHAEL J. PAPPAS, PhD., individually and as Trustees of certain trusts entitled Biomedical Engineering Trust,

Plaintiffs,

- against -

JOHN N. BAIN, JOHN G. GILFILLAN, III, and CARELLA, BYRNE, BAIN, GILFILLAN, CECCHI, STEWART & OLSTEIN,

Defendants,

- and -

R. GALE RHODES, JR. and PAUL A. WITTE, as beneficiaries of a certain trust entitled BIOMEDICAL ENGINEERING TRUST,

Defendant-Beneficiaries.

Appendix E

RICHARD B. LOWE, III, J:

Plaintiffs, an orthopedic surgeon and a mechanical engineer engaged in the invention, research and extraordinarily successful marketing of prosthetic devices over the past 25 years (the plaintiffs) move for partial summary judgment on their first three causes of action seeking to rescind all equity interest held by two attorneys in a trust agreement (Trust 1) entered into in December 1983 with one R. Gale Rhodes, Esq. and his then former patent law partners John N. Bain and John G. Gilfillan (the defendants, both of whom were discharged as attorneys for the trust in January 1995) who cross move to dismiss the first four causes in the complaint. Defendants, residents of New Jersey, participated in the operation of the business venture until 1983 while prosecuting and defending numerous patents from its inception in 1974 until their discharge in January 1995.

The first three causes of action seek, essentially, to recover the approximately $7,000,000 in royalties received by the defendants pursuant to their combined 22% interest in the various business ventures and to relegate them to the payment of legal fees on a quantum meruit basis in reliance on a similar outcome in the earlier litigation (the Rhodes action) tried under index no. 8055/87, in which plaintiffs prevailed under the doctrine of collateral estoppel invoked on their counterclaims in the Rhodes' action. This courts judgment, following a lengthy trial, was issued on May 14, 1998 (aff , NYLJ, 2-8-99 p 26 c3), "rescinding ab initio any interests Rhodes holds, or may have held in Trusts I and II" (the second trust was formed to segregate certain inventions

on which Rhodes had performed all relevant patent law services) based on the finding that the business ventures jointly formed by plaintiffs and Rhodes "were entered into in violation of the ethical duties owed by attorneys to their client." According to the appellate affirmance" the record supports the trial court's findings that neither the initial arrangement (a partnership formed in October 1 974) nor its subsequent incarnations (Biological Engineering Corp., (BEC) established in July 1975 and its successor-in-interest created by the 1983 trust agreements) were entered into upon adequate disclosure "of other possible fee arrangements and potential conflicts of interest."

The main motion is granted rescinding Trust I and awarding a conditional judgment for all moneys distributed to defendants less reasonable attorney fees and dismissing plaintiffs's fourth cause for legal malpractice. Conversely, the cross motions are denied and defendants' counterclaims alleging breach of contract and fiduciary duty and seeking an accounting on the parties invalid trust agreement are dismissed as moot with the exception of the attorney fees pleaded in the sixth counterclaim. The issue of rescission was essential to the outcome and was thoroughly litigated in the Rhodes trial, in which defendants had ample opportunity to participate. Actively recision issue was squarely placed in issue in the counterclaims served in December 1991 in the Rhodes action and defendants were fully familiar with the ethical scope of these claims. Their basic awareness of the "potential preclusive effect" of an outcome favorable to Rhodes is conceded in the opposing papers by defendants' counsel and defendants acknowledged informally during the course of the Rhodes litigation that their own stake in the

business venture might very well hinge on its outcome. It fact, they applied in 1995 to stay this action pending resolution of the Rhodes trial arguing the likelihood of its having an estoppel effect.

Nevertheless, defendants, who were nominal parties in the Rhodes case, elected to elude every opportunity afforded them to participate actively in trial preparation or the trial itself, where Rhodes presented extensive expert testimony on the central issue of professional ethics and otherwise offered a vigorous defense to the rescission counterclaims. Defendants successfully opposed a belated motion to add them on the eve of trial as parties to the counterclaims along with Rhodes and later quashed subpoenas citing them as witnesses based on their New Jersey residence. In addition, Rhodes' attorneys announced at the trial's inception the well-founded intention of calling defendants to the stand as voluntary witnesses. Hence, defendants protestations of entitlement to litigate de novo because they were never in a position to oppose plaintiffs' rescission claim is manifestly unconvincing.

Defendants' contentions that they were not in legal privity with and had actually adverse interests vis a vis Rhodes during the prior litigation, is also unpersuasive and runs counter to fundamental principles of fairness and equity. The three attorneys had identical interests in the success of BEC and defendants maintained their same beneficial share in the successor Trust 1 entered into after Rhodes left the law firm. The fact that their role in the management of the business venture was curtailed and the 1983 trust documents created a separate source of income for Rhodes

(i.e., Trust 1), thereby reducing defendants' equity fees on plaintiffs prosthetic inventory did not alter the three attorneys' basic mutuality of interest on the litigated issue of professional ethics. That is, all three were equally exposed to financial loss in the event plaintiffs prevailed on their counterclaims for rescission. On this score absolutely no adverse relationship existed between them. On the contrary, having acted in concert in the formation of their business venture with plaintiffs in 1974 the attorneys had every incentive to join forces in the Rhodes action and actually did cooperate somewhat in Rhodes trial preparation. More importantly, they have not shown that their failure to fully participate in the Rhodes action affected its come.

In sum, judging by the context of defendants' affidavits in the present action, their testimony in the Rhodes action, even assuming its veracity, would not have met the standard of professional conduct applied in the prior case, having failed to allege, inter alia, that plaintiffs were informed their attorneys could be replaced without penalty.

Moreover, there is no merit to the contention that plaintiffs waived their right to rescind Trust 1 by continuing to retain defendants until their discharge in January 1995 and by lulling them into a sense of security by not proceeding against them directly in the context of the Rhodes action. First, since it was most unreasonable for defendants to rely on a disputed laymen's oral exchange with plaintiffs on the complex legal issues of professional ethics and estoppel, no material issue of fact is raised on the rescission claims by the purported reassurance given by plaintiffs. Also, no prejudice has been shown since defendants are fully entitled

to recover for all legal services rendered until their discharge. Further, defendants' claim of deceptive conduct as to their continued retention without complaint long after defendant became aware by 1982 of alleged deficiencies in the prosecution of two patent applications has been mooted by the dismissal of plaintiffs' time barred fourth cause of action for legal malpractice.

Nevertheless, while defendants maintain correctly that these discreet transaction are not covered by the doctrine of continuous representation relied by plaintiffs, the doctrine clearly applies to the issue of professional ethics at the heart of the present litigation. In short, given the fact that "the parties relationship . . . remained at all times that of attorney-client" (as noted in the appellate affirmance cited above), the Statute of Limitations did not accrue until the termination of plaintiffs uninterrupted course of reliance on defendants' legal representation in January 1995. This conclusion is especially compelling here, where the fundamental issue of professional ethics is at stake rather than the far less serious issue of professional negligence raised in plaintiffs' fourth cause of action.

Accordingly, plaintiffs are awarded partial summary judgment on their first, second and third causes of action terminating and rescinding ab initio defendants' equity interest in the three legal entities negotiated by the parties and Rhodes between 1974 and 1983 and directing defendants to return all fees distributed to them less the reasonable value of their legal services rendered following resolution of the attorney fee issue on a quantum meruit basis. The fourth cause of action for legal malpractice is dismissed.

Appendix E

Settled order, providing for a severance of the remaining claims.

Dated: May 26th, 1999 .

s/ Richard B. Lowe III
JUDGE RICHARD B. LOWE III

APPENDIX F — ORDER OF THE SUPREME COURT, COUNTY OF NEW YORK, STATE OF NEW YORK FILED FEBRUARY 23, 1995

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 25

Index No.: 8055/87

Cal. No.: 222 of 2/17/95

R. GALE RHODES, JR.,

Plaintiff,

-against-

FREDERICK F. BUECHEL and MICHAEL J. PAPPAS, individually and as Trustees of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants,

-and-

JOHN N. BAIN and JOHN G. GILFILLAN, III, as beneficiaries of a certain trust entitled Biomedical Engineering Trust, and PAUL A. WITTE, as beneficiary of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants-Beneficiaries.

Appendix F

DeGRASSE, J.:

This motion by defendants for leave to amend their counterclaims is denied. The stated purpose of the proposed amendment is to expand the prayer for relief against John N. Bain and John G. Gilfillan III who have been counterclaim defendants for the past seven years. The instant motion was made five months after the note of issue was filed following protracted discovery. Defendants have not offered an acceptable excuse for their delay in making the instant application. The supporting affidavit alludes to an October 1994 decision of the German High Court for Patents. However, it has not been shown that the proposed amended counterclaims did not accrue and could not have been interposed at a more appropriate time. To grant the requested relief would require plaintiff to either waive discovery to which he would be entitled or face the prospect for further delay of this eight year old lawsuit.

Plaintiff's cross-motion for an order striking defendants' supplemented responses to plaintiff's expert interrogatories is granted to the extent that defendants shall be precluded from calling Geoffry C. Hazard, Jr., Michael P. Ambrosio and Eugene Rzucedlo as expert witnesses unless defendants pay the firm of Leventhal, Slade & Krantz a counsel fee of $8,000 and produce the said witnesses for depositions to be conducted at defendants' expense on March 13, 1995 at 10:00 a.m. at the office of plaintiff's counsel or at such other time and place as the parties shall agree to in writing. The expert witness interrogatories which relate to defendants' counterclaims were served on November 4, 1993. Defendants' December 8, 1993 response indicated that as of

that date defendants had not decided who their expert witnesses would be. The supplemental response naming the expert witnesses was not served until January 10, 1995, four months after the note of issue had been filed. Plaintiff has been prejudiced by defendants' delayed response which limits plaintiff's time to engage his own expert witness to offer testimony in rebuttal. Accordingly, the conditions imposed herein are within the sound exercise of this court's discretion (*see, McDermott v. Alvey, Inc.*, 198 AD2d 95). The required counsel fee shall be paid by March 13, 1995. Plaintiff's application for sanctions is denied in light of the foregoing. Copies of this order have been mailed to the parties on the date of signature.

This constitutes the decision and order of the court.

DATE: February 23, 1995 s/ [illegible]

APPENDIX G — ORDER OF THE SUPREME COURT, COUNTY OF NEW YORK, STATE OF NEW YORK FILED MARCH 4, 1998

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 54

Index No. 8055/87

R. GALE RHODES, JR.,

Plaintiff,

-against-

FREDERICK F. BUECHEL and MICHAEL J. PAPPAS, individually and as Trustees of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants,

-and-

JOHN N. BAIN and JOHN G. GILFILLAN, III, as beneficiaries of a certain trust entitled Biomedical Engineering Trust, and PAUL A. WITTE, as beneficiary of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants-Beneficiaries.

Appendix G

HON. RICHARD B. LOWE, III:

A bench trial was held before me from April 24,1995 through July 10, 1998. R. Gale Rhodes, Jr., plaintiff sued Frederick F. Buechel and Michael J. Pappas, individually and as Trustees of Biomedical Engineering Trust and Biomedical Engineering Trust II. Plaintiff seeks to recover millions of dollars for improper trust payments which defendant trustees Buechel and Pappas have made to themselves. Further, plaintiff seeks to remove them as trustees and to require the trusts to pay plaintiff his share of trust income which has been withheld since 1987. In sum, Plaintiff seeks more than $6 million dollars, also a share of future royalties.

Defendants Buechel and Pappas counterclaim, seeking the forfeiture of trust income to Rhodes as a result of alleged unethical activity. Further, defendants seek monetary damages of $4,013,367.00 plus interest, as a result of the alleged acts of patent malpractice. More specifically, defendants Buechel and Pappas claim that Rhodes was negligent in connection with two patent applications. First, defendants claim that they incurred $2,013,367.00 in damages as of April 25, 1995 for the '451 Patent. Additionally, defendants Buechel and Pappas seek $2,000,000.00 in damages as a result of Rhodes' alleged negligence in the prosecution of the '658 patent.

In an effort to render a concise decision this Court has elected to address the ethical issues raised by defendants Buechel and Pappas at the outset, because any conclusion that plaintiff Rhodes acted in violation of his ethical responsibilities may result in the forfeiture of legal fees.

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The Court's findings of fact and conclusions of law are as follows:

FINDINGS OF FACT

Plaintiff R. Gale Rhodes, Jr., is a member of the Bar of the State of New Jersey, whose practice is primarily in the area of patent law. He received his training in the area of patent law at Western Electric and has been a private practitioner since 1964.

Defendant Frederick F. Buechel is an orthopedic surgeon associated with several New Jersey medical institutions. He is also a professor of orthopedic surgery at New Jersey Medical School.

Defendant Michael Pappas is a mechanical engineer who has worked on inventions since 1958. His past employment included working as a professor at the New Jersey Institute of Technology and for Lockheed and Sheppard Industries. He was the proud owner and operator of Orginetics, a company which commercially exploited many of his inventions.

In 1974, at the suggestion of the Chief of Orthopedics at the New Jersey Medical School, Frederick F. Buechel and Michael Pappas met. This was the beginning of a successful and prosperous joint venture, the collaboration to invent prosthetic devices. Their goal clearly was to enhance the quality of existing products on the market thereby enhancing the quality of life for persons in need of prosthetic devices and to make money in the process. Today, they are extremely successful businessmen, both holding a large number of patents on important developments in the field of joint replacement.

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As a result of their accomplishments being widely published they have gained great notoriety and success.

Defendants began working together and soon developed drawings and a prototype for a "Floating Center Prosthetic Joint." In September 1974, they displayed a brass model of their shoulder prosthesis device to Howmedica, a prominent manufacturer of prosthetic devices. During their conversations with Howmedica they learned that Howmedica was working on a similar device with others. Therefore, Howmedica declined the opportunity to work with them.

The knowledge that Howmedica was working on a similar device caused them to become anxious. They wanted their invention patented and on the market first. Thereafter, believing that they needed urgent legal assistance, Pappas recommended to Buechel that they immediately consult Rhodes, a patent lawyer with whom he had previously worked.

At this time, Rhodes was in a partnership with two other patent lawyers, John N. Bain, Esq. and John Jack Gilfillan III, Esq. The partnership dissolved in December 1981.

The parties met several times during the fall of 1974 and agreed that Rhodes and his law partners, Bain and Gilfillan, would receive one-third interest in any inventions that Buechel and Pappas would bring to them, in return for legal work to include drafting and prosecuting patent applications, both foreign and domestic, working on licenses for exploiting the inventions, and providing other assistance and advice as became necessary. Rhodes and his law partners had never before accepted a contingency fee for patent law

services. Further, the testimony revealed that the acceptance of a contingency fee is not a customary practice in the area of patent law.

In an effort to induce a contingency fee arrangement Rhodes told Buechel and Pappas that a one-third contingency fee arrangement "was a usual arrangement." Further, Rhodes informed them that it was essential to file a patent application promptly in order to obtain priority over Howmedica. Moreover, Rhodes warned them that Howmedica would probably initiate an "interference proceeding" challenging Buechel and Pappas patent rights. Thus, leading them to believe that legal protection was necessary immediately. Simultaneously, Rhodes lead Buechel and Pappas to believe that they would incur a great expense defending (a possible) an interference proceeding.

With regard to their individual contributions to the joint venture, Beuchel and Pappas would be required to spend a tremendous amount of time and energy developing their inventions and bringing them to commercial viability. This, along with the inventions, would be their contribution to the joint endeavor, for which they would each receive a one-third interest.

A one paragraph fee agreement was executed on October 8, 1974, but a copy was never furnished to Buechel and Pappas. Thereafter, their agreement was memorialized in a simple three page document dated November 12, 1974. The agreement set forth that Bain, Gilfillan and Rhodes agreed to provide patent legal services in return for an assignment of a one-third interest in the floating - center -

prosthetic joint device. Further, all parties agreed to contribute their pro-rata share of any "out of pocket expenses associated with such patent prosecution," as well as a tester for the device and any other development or marketing expenses mutually agreed upon. The agreement further provided that proceeds received by any party would have to be shared by all.

Buechel and Pappas executed an assignment to the law firm of a one-third equity interest in the invention and, in any patents and proceeds that issued therefrom. The effect of such was that Buechel, Pappas, Rhodes and his partners had become involved in a joint venture.

The Court notes that Rhodes failed to discuss with Buechel and Pappas alternative payment arrangements, such as a sliding scale fee, a cap on royalties or compensation based on the reasonable value of the services rendered.

Although the parties had crystallized their understanding in writing, the fee agreement did not reflect all of the promised services. For example, the fee agreement omitted certain important responsibilities of Rhodes and his partners. More specifically, the fee agreement failed to set forth that Rhodes and his partners would prosecute and defend both infringement and interference proceedings.

Rhodes concedes that at this stage he failed to advise Buechel and Pappas to obtain independent counsel. Further, the Court finds that Rhodes failed to inform Buechel and Pappas of the potential conflicts of interest that might occur when a lawyer enters into a business transaction with his client.

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Thereafter, Rhodes formalized the relationships between inventors and lawyers by forming Biomedical Engineering Corporation. The purpose of Biomedical Engineering Corporation was to exploit their inventions and make money. Rhodes believed that a corporation was the best vehicle because a corporation could use pretax dollars to fund research, development and marketing. Further, Rhodes believed that a corporation could retain the resulting tax "losses" to be applied against future income. This was something which Rhodes believed individuals and partnerships could not offer. Thus, Rhodes believed the corporate form proposed a more suitable vehicle for doing business.

The Court finds that at this stage, Rhodes again failed to advise Buechel and Pappas to consult independent counsel. On July 7, 1975, Biomedical Engineering Corporation, a New Jersey Corporation, was formed. Beuchel, Pappas and Rhodes were designated as the officers and directors of Biomedical Engineering Corporation. Rhodes served as President, running the corporation out of his law offices.

The first patent application, entitled "Floating Center Prosthetic Joint" was rapidly developed. Rhodes prepared the claims expressly setting forth the invention as explained to him by Buechel and Pappas. The claims reflected all information brought to his attention at that time. Thereafter, Rhodes broadened the claims beyond the shoulder prosthesis which the inventors had brought to him, after ascertaining that the invention could be used in other joints such as knees, fingers, ankles, etc. At the same time, Rhodes did not seek to redefine or broaden the invention itself, which the inventors now say, 20 years after the fact, was his obligation as a patent lawyer. However, the Court notes that at the time

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Rhodes and Buechel believed that the claims drafted by Rhodes accurately reflected their invention and sufficiently protected their rights.

The application was approved and a patent was issued on November 14, 1975. This patent represented the first of eighteen patents issued which were prepared and filed by Rhodes.

Buechel and Pappas continued to collaborate on the development of the prosthetic devices such as the knee, hip and shoulder implants, including an "Integrated Knee Replacement System." On July 16, 1975, they assigned to Biomedical Engineering Corporation their interest in the invention, and in any patents that might issue therefrom. Thereafter, stock was issued as follows: one-third of the shares to Beuchel, one-third to Pappas, one-ninth each to Bain, Gilfillan and Rhodes individually. From 1975 to 1983, Biomedical Engineering Corporation served as the vehicle for exploitation of the inventions until it was dissolved and its property turned over to Biomedical Engineering Trust in late 1983.

The Court finds that Rhodes failed to perform certain key tasks. More specifically, Rhodes failed to prepare a shareholders agreement. Further, he failed to memorialize his oral promise that the lawyers would earn their equity in Biomedical Engineering Corporation only in exchange for their future performance of legal services. Rhodes had become an owner of the corporation, entitling him to share equally in the profits with his partners.

Here again, Rhodes failed to advise Buechel and Pappas of potential conflicts of interest that would arise as a result of converting the attorney's one-third interest in a single

invention, into a one-third equity interest in a corporation which would exploit all of their future inventions. At no time did Rhodes disclose the existing conflict of interest involved in his firm serving as counsel while having an equity interest in the corporation. Further, Buechel and Pappas were not informed that they could discharge their lawyers at any time, without penalty and thereby extinguish the lawyers' contingency equity interest in the corporation. In this case, they could discharge their lawyers at any time because the proper disclosure was not made.

Rhodes informed Buechel and Pappas that they "could not go into a business which would be in the same area that was of interest to Biomedical Engineering Corporation." The Court finds this statement to be significant because it reflects that Rhodes primary concern had become making money and not his clients' best interest. Further, the statement mislead Beuchel and Pappas, causing them to believe that all of their future inventions would belong to Biomedical Engineering Corporation.

In 1977 Biomedical Engineering Corporation entered into an agreement with DePuy, a prominent manufacturer of prosthetics and a division of Bio-Dynamics, Inc. The agreement licensed DePuy to manufacture, sell and distribute a "Floating Center Shoulder Prosthesis" and a "N.J. Knee." The first license dated April 25, 1977 provided for a very high royalty rate, including a rate of 15% for the "New Jersey knee." This uniquely high royalty rate proved to be a contributing factor for the endeavor's financial success. The agreement with DePuy was simply remarkable. Another extraordinary feature of the agreement was that the license covered the "devices" not merely

the patent rights. Thus, DePuy would have to pay royalties whether or not patents were granted. Further, royalty payments would continue after the expiration of the patents. The license was amended and superseded by a later agreement.

Ultimately, the collaborative efforts of Buechel and Pappas led to the successful development and marketing of many prosthetic-related devices and equipment. Such efforts have resulted in the payment to date of approximately $50 million in royalties.

The Court finds that from the outset all parties realized the significant effort involved and that their compensation for their particular contributions would be their eventual share of the proceeds obtained from exploiting the inventions, if any. This appears to have been clearly agreed on.

With regard to the first patent, the "451 Patent" previously mentioned, Rhodes filed the patent application on October 25, 1974, with each of the original seventeen claims defining the proposed monopoly as requiring that both the first and second surfaces of the floating bearing surface have a "cross-section conforming to a circular arc."

Buechel and Pappas now contend that there was no reason for this limitation. Further, they argue that this particular limitation substantially reduced the scope of the patent monopoly received. The Patent office allowed all of the clams in the first office action (except one, claim 11, which was rejected on procedural grounds).

Defendants, Buechel and Pappas now contend that Rhodes should have noted and removed the unnecessary

"circular arc" limitation which made the claims prepared by Rhodes unduly narrow. This contention forms the basis of their alleged patent malpractice claim herein.

As a result of broad language contained within a Goodfellow-Oxford patent, the company successfully asserted a claim against DePuy. DePuy was sued as the result of being the holder of the license of the Buechel-Pappas knee device.

As a result of DePuy's inability to assert an infringement claim or negotiate a cross-license with Goodfellow-Oxford. DePuy was forced to pay royalties to Goodfellow-Oxford. Defendants assert that the failure of Rhodes to draft the '451 patent' claims broadly, cost them a great deal of money. More specifically, DePuy paid royalties to Goodfellow-Oxford under a license for the invention which cost defendants $2,013,367.00, that is, reduced the royalties which they received by such amount.

The testimony further revealed that in 1980 Pappas informed Rhodes that he believed Mr. Robert Averill had a patent which conflicted with a Beuchel-Pappas invention licensed to DePuy. Further, he asked Rhodes to bring a lawsuit against Mr. Averill. Although Rhodes prepared a draft complaint and forwarded it to Mr. Averill along with supporting documents, a settlement was not reached. Thereafter, Rhodes refused to bring the lawsuit unless he was paid an hourly rate.

During the period of time from October 8, 1974 through late 1983, Rhodes worked diligently on behalf of Buechel and Pappas securing patents. However, the record fails to establish

that Buechel and Pappas were ever informed of the potential conflicting interests which had entangled their interests.

Prior to October 16, 1979 Buechel and Pappas provided Rhodes with the disclosure for the '658 Patent', which included a "split-collar" and "split bearing" embodiment. The testimony reveals that in July 1980 Pappas submitted to Rhodes a patent disclosure, essentially a patent application for both the "split collar" and "split bearing" embodiments. Further, the record revéals that Rhodes did not file the application for more than two years because he was instructed by the defendants to wait until they had discussed and resolved important issues with DePuy. The patent office cited an item of prior art which prevented Buechel and Pappas from obtaining broad claims.

Dr. Ramos successfully sued Biomet company, the company that marketed the infringing device, for patent infringement and received a judgment for compensatory damages of $2,000,000.00. The Court finds that the defendant's device was different from that of Dr. Ramos.

At the end of 1981, Rhodes withdrew from his law partnership with Bain and Gilfillan. The dissolution proved to be apocryphal. The testimony revealed that Rhodes had difficulty resolving the issue of what would occur with respect to the inventions that Rhodes was working on after the dissolution. Now Rhodes was a solo practitioner and the desire to share compensation with Bain and Gilfillan was gone. Rhodes was seeking a new understanding and wrote several aggressive letters to his former partners in support of such.

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Over the next thirteen years, Rhodes worked diligently on the Buechel and Pappas inventions. He worked on 27 patent applications during this period of time, which resulted in more than 20 United States patents. Further, through extraordinary efforts Rhodes secured several foreign patents and licensing agreements. Unequivocally, the Court finds that Rhodes worked diligently on behalf of the defendants over the next several years. Further, the Court finds that Rhodes worked without compensation in complete reliance on the agreement of 1974. However, troublesome to the Court is the fact that Rhodes engaged in the following questionable activity:

- Unbeknownst to Bain and Gilfillan, Rhodes incorporated a company named Endomedics, and allocated its stock one-third to Buechel, one-third to Pappas and one-third to himself.

- Endomedics began to develop, manufacture and market products already licensed to DePuy by Biomedical Engineering Corporation.

- In January 1983, Rhodes formed a Florida corporation naming it Biomedical Engineering Corp.

- Rhodes caused checks from DePuy intended for Biomedical Engineering Corporation (New Jersey) to be deposited in an account owned by Biomedical Engineering Corporation (Florida).

- Unbeknownst to Bain and Gilfillan, Rhodes opened a second New Jersey bank account in the name of Biomedical Engineering Corporation.

- Rhodes caused a $22,500.00 check from DePuy to Biomedical Engineering Corporation to be deposited in the above stated account.

In January 1983 Rhodes exchanged letters with Bain and Gilfillan, copies of which were sent to Buechel and Pappas. Rhodes indicated the firm breached its obligations to perform continuing services for Buechel and Pappas by breaking up. Further, Rhodes acknowledged that the diversion of inventions to Endomedics and of funds to Biomedical Engineering Corporation Florida could expose Buechel and Pappas to a claim for the misappropriation of a corporate opportunity.

Rhodes suggested that by "unanimous consent of the stockholders" Biomedical Engineering Corporation be dissolved and "the inventions be reassigned to Mike and Fred jointly." The Court finds that this particular letter mislead Buechel and Pappas into believing that the unanimous consent of the parties was required to dissolve Biomedical Engineering Corporation, when in fact, Buechel and Pappas could discharge their attorneys at any time. Further, Rhodes' letter suggested that he was amenable to the equity interests being returned to Buechel and Pappas, jointly.

In 1981, Rhodes was advised by an accountant that the shareholders of Biomedical Engineering Corporation would be exposed to a substantial tax liability on any royalty income received by the corporation. The adverse tax consequences were not immediately brought to the attention of Buechel and Pappas. Two years expired before they were made aware of this fact. Further, Rhodes did nothing to correct the tax consequences until 1983. In late 1982, Beuchel's accountant,

Patrick Power, suggested that Buechel consult his brother, John Power, Esq., a New York City tax attorney, with regard to the Biomedical Engineering Corporation tax problem.

Buechel and Pappas, concerned about the tax consequences which they faced and the turn of events with regard to Rhodes and his firm, consulted John Power, Esq. Patrick Power, Buechel, Pappas and Rhodes met with John Power for the first time to discuss the tax problems facing Biomedical Engineering Corporation and the dissolution of the law firm of Bain, Gilfillan and Rhodes. Thereafter, Power met twice with Buechel, Pappas, and either Rhodes, Bain or Gilfillan were in attendance.

In 1983, Biomedical Engineering Corporation retained Power. Power was hired to give the corporation tax advice, and determine from a tax perspective whether or not it was feasible to dissolve the corporate entity and, if so, to determine what should happen with respect to the patents and other corporate assets.

The Court notes that Power was not asked to review the propriety of the fee arrangements. Power merely recodified the existing fee arrangement within the Trust instrument. Further, the Court notes that Power was not asked to determine whether or not such arrangement had been made after full disclosure of conflicts or to evaluate the overall fairness of the business venture.

Power did seek copies of all documents concerning the origin of the relationship amongst the parties from Rhodes. However, the 1974 Fee Agreement executed by the parties

was never sent to Power. Moreover, Rhodes informed Power that no such document existed.

In April 1983, Power advised the shareholders that Biomedical Engineering Corporation could be dissolved and its assets "transferred to its shareholders without the imposition of substantial additional taxes." This could be accomplished if the assets were transferred to a trust created for the benefit of the shareholders in proportion to their respective stock holdings. This would solve the tax problems caused by the corporate form.

In late 1983 Biomedical Engineering Corporation was dissolved and its assets transferred to Biomedical Engineering Trust, hereinafter referred to as "Trust I." The trust also served to collect and distribute any royalty income from the licenses with DePuy. The shareholders of Biomedical Engineering Corporation received a beneficial interest in Trust I, equivalent to their former equity interests in Biomedical Engineering Corporation, as follows: one-third to Buechel, one-third to Pappas, and one-ninth each to Rhodes, Bain and Gilfillan (less one-and-one-half percent to Paul Witte).

The trust agreement, drafted by Power, made Bain and Gilfillan specifically responsible for prosecuting and defending the patents. Further, it released Rhodes from any further obligation in this regard. Additionally, it discusses the role of the trustees in general terms. The trust agreement is silent on whether or not the trustees may pay themselves for work outside of their fees as trustees. Fees are 2% per year of moneys received and distributed to the beneficiaries.

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The Trust II agreement specifically obligated Rhodes to prosecute and defend patents owned by Trust II, although it provided that Rhodes could decline to provide those services or the trustees could retain other counsel in the best interest of the Trust."

As a result of the dissolution of the law firm, a second trust had to be formed. Rhodes' former partners agreed, albeit, reluctantly to waive any interest in the inventions which Rhodes had principally worked on, after their partnership dissolved. Hence, the second trust, "Trust II" was formed. This trust was created to be the assignee of all the inventions on which Rhodes worked after leaving Bain and Gilfillan, which had not been assigned to Trust I, principally the components of the "New Jersey Integrated Hip." The beneficial interests of Trust II were allocated as follows: one-third to Buechel, one-third to Pappas, and one-third to Rhodes (less a one-and-one-half percent interest to Paul Witte).

In June 1983, Rhodes demanded that Power include language in the Trust Agreement that would release him from responsibility for the legal work for the knee and shoulder devices, or threatened that he would not give any release to his former partners. Power included the proposed release language in Article 32 of the trust agreements; Bain and Gilfillan would be responsible for all legal services related to the knee and shoulder devices (Trust I), while Rhodes would be solely responsible for the legal services related to the hip devices (Trust II). Further, Rhodes was released from any other obligations.

The Court accepts the contentions of Buechel and Pappas that they agreed to Rhodes demand because Rhodes, Bain

and Gilfillan were no longer able to work together and if the trust agreements were not executed, they would be subject to the adverse tax effects of continuing Biomedical Engineering Corporation. Defendants' contentions are supported by the fact that Rhodes demanded to be released from his obligation to work on the knee device as a condition precedent to agreeing upon the formation of the Trust. The Court finds that at this crucial point, Buechel and Pappas were not advised that they had a right to terminate the Fee Agreement - that was reflected in the equity structure of Biomedical Engineering Corporation by discharging the attorneys without financial penalty.

Plaintiff asserts that Power was retained by Buechel and Pappas and served as independent counsel. Defendant's deny this claim arguing that he was retained by the corporation.

Despite the fact that Power closely scrutinized the previous acts of Rhodes and Rhodes' role in the joint venture, i.e., in a letter to Rhodes he wrote "your incorporation of Fred and Mike in 1975 was a very serious mistake, which, under the circumstances, would subject you to a malpractice action", he was not hired by them in their individual capacity, but rather retained by the corporate entity. The Court finds that Power's criticism of Rhodes' roles in the business venture was squarely grounded in the Rules of Ethics and in all likelihood what any other lawyer would have stated.

Thereafter, Power recommended that Buechel and Pappas be the sole trustees because Rhodes active role in protecting the inventions from competition precluded his being a trustee. Power informed Rhodes that a trustee could not have two conflicting active roles in a trust fund.

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Rhodes was removed as legal and business advisor to the enterprise. The roles of Rhodes and his former partners was limited to prosecuting and defending their patents. Further, the lawyers were responsible for bearing the financial cost of the legal work necessary to protect and maintain the patents, notwithstanding whether or not they performed the work. After the trust agreements were executed and until 1987, Rhodes continued to render legal advice to Buechel and Pappas with respect to a variety of personal matters.

Buechel and Pappas were given a list of their duties as trustees, which included the following: opening bank accounts, depositing the royalty checks from DePuy, distributing royalties to the beneficiaries and hiring an accountant to audit books and records of DePuy.

During the summer of 1986 DePuy sought from Buechel and Pappas evidence which they could use to rebut a claim of patent infringement against DePuy made by the holders of the "Noiles patent." Buechel made several requests for this evidence from Bain and Gilfillan, patent attorneys for Trust I, but it was never furnished. In sum, DePuy settled with the Noiles interests which resulted in the loss of substantial royalty income to Trust I. Based on this and other incidents Buechel and Pappas came to believe that the lawyers were not performing promised legal services and having obtained an interest in the proceeds of the business venture only cared about the money to be made.

From 1984 through the beginning of 1987, Rhodes worked on a number of inventions and filed several patent applications. The inventors continued their research and

development efforts. Trust I finally began to generate income. In the first fiscal year it generated $182,518.00; in the second $314,284.00 and in the third $1,519,409.00. The parties received their pro rata shares one-third each to Buechel and Pappas ($29,380.00 in the first year; $82,901.00 in the second and $393,655.00 in the third) and one-ninth each to Bain, Gilfillan and Rhodes ($9,785.00 in the first year; $27,463.00 in the second year, and $129,406.00 in the third year).

In mid 1986, Buechel became aware that the hip prosthesis designed by defendants and manufactured by Howmet Turbine Components Corp., contained small "beads" that separated from the prosthesis after they were implanted in approximately a dozen of his patients. Upon gaining this information, Dr. Buechel took measures to have the product recalled.

Further, defendants created an emergency program to test the product and to ensure that the defective devices were discarded. Rhodes assisted the defendants in this endeavor. Further, Rhodes discussed the matter with Howmet and assured the company that all appropriate measures to correct the problem were being taken.

During this time period Buechel and Pappas devoted substantial time to improving their inventions through research and development. Further, they devoted substantial efforts to promotional marketing activities designed to induce surgeons and others to use the inventions. Their efforts lead to the tremendous success of their products. Thereafter, Buechel consulted with Pappas and Rhodes as to his belief that he and Pappas should be compensated for services to the trusts outside of their duties as Trustees and suggested that they

meet to discuss the subject of compensation for work performed. Rhodes declined to meet with Buechel and Pappas unless he could bring along litigation counsel. The parties had reached an impasse. Rhodes had become entangled with defendants in a dispute concerning compensation for research development and marketing of the inventions.

After having consulted with Power, Rhodes, Bain and Gilfillan and in reliance on opinions by Power and the written consent of Bain, Gilfillan and Witte, Buechel and Pappas took compensation for their services to the Trusts.

The Court finds that the trust agreements, although specifically silent on the issue of payment for work outside of fees, contained broad provisions authorizing the continuation of research and development and marketing activities previously conducted by Biomedical Engineering Corporation, and authorizing payment of compensation thereof. Further, the trust agreement provides that the trustees shall have the specific powers "to perform any act authorized, permitted or required" under the licenses. This Court finds that the licenses to DePuy required Buechel and Pappas to engage in research, development and marketing.

Most significantly, the trust agreements provide for ratification of the trustees' actions by votes of the beneficiaries. The Trust I agreement contains a provision that rendered Buechel and Pappas' actions "final and binding" if approved by 75% of the beneficial interests in the Trust.

In April 1987, Buechel and Pappas issued their report and account for Trust I for the fiscal year ending January 31,

1987. The report disclosed past and anticipated compensation to Buechel and Pappas for research and development and marketing services. All of the certificate holders constituting 89% of the interests except for Rhodes, signed and ratified the report.

On December 23, 1986 after rejecting an invitation by Pappas to discuss Buechel and Pappas' desire for payment for their research, development and marketing services, Rhodes sued Buechel and Pappas in New Jersey and sought to have them removed as trustees. Rhodes alleged that they were dishonest and had breached their fiduciary duties by taking compensation for their services to the trusts.

In January 1987, at the advice of Power, and as a result of being sued by their attorney, Buechel and Pappas terminated Rhodes' services. As a result of being discharged, Rhodes engaged in the following questionable activity, much of which he candidly admits was irrational at the time:

- Rhodes filed an affidavit with the New Jersey Superior Court disclosing confidential information concerning the bead separation problem.

- Rhodes threatened to depose Buechel's patients on the issue of pain and suffering. This stemmed from Rhodes' allegations that Buechel's patients might be suffering pain as a result of the device.

- Rhodes threatened to hire Buechel's supervisor, Dr. Andrew Weiss, as an expert to establish that Buechel had committed acts of negligence.

- Rhodes threatened to publicize the alleged acts of negligence by Buechel, if Buechel and Pappas failed to yield to his demands that they step down as Trustees.

- Rhodes sought the names of Buechel's patients so that he could solicit their assistance in suing Buechel.

- Rhodes sought an advisory opinion form the New Jersey Supreme Court Advisory Committee on Professional Ethics as to whether or not he could bring a malpractice action against Buechel, a former client. Rhodes sent a copy of such to Buechel.

Thereafter, Rhodes brought the present action against defendants in New York. To date, Rhodes has been paid approximately $500,000.00 for legal services rendered.

CONCLUSIONS OF LAW

At the outset, the Court points out that the choice of law is largely irrelevant, as New Jersey law is no more favorable than New York law on the issues presented. The Court finds that plaintiff R. Gale Rhodes, Jr. violated his professional and fiduciary obligations in contravention of the Code of Professional Responsibility.

A lawyer is prohibited, except with the client's consent after full disclosure, to accept employment if the exercise of his professional judgment on behalf of the client will or may

reasonably be affected by the lawyer's own financial or personal interests. DR5-101(A); 22 NYCRR 1200.20(A).

DR5-104(A) (22 NYCRR 1200.23(a)) states, in pertinent part, that "[a] lawyer shall not enter into a business transaction with a client if they have differing interests therein ..... unless the client has consented after full disclosure." In addition, to the dubious propriety of Rhodes having gained a business interest in his clients' invention, by turning such into an investment opportunity for his own benefit, he simultaneously failed to discuss with his clients the legal implications of his assuming a one-third share of the subject corporation, Biomedical Engineering Corporation.

Although an attorney is not prohibited from entering into a contract with a client, such an agreement is not advisable. *Greene v. Greene*, 56 NY2d 86, 92 (1982). Upon forming the corporation, accepting one-third of the profits of the inventions in return for legal services, and failing to fully disclose the potential conflicts, it is clear that Rhodes violated DR 5-101(a), 5-104(a) and his fiduciary obligations. In *Matter of Cooperman* 83 NY2d 465, 472 (1994) the Court of Appeals stated the following:

> This unique fiduciary reliance, stemming from people hiring attorneys to exercise professional judgment on a client's behalf_ "giving counsel" _ is imbued with ultimate trust and confidence. The attorney's obligations, therefore, transcend those prevailing in the commercial market place. The duty to deal fairly, honestly and with undivided loyalty superimposes onto the attorney-client

> relationship a set of special and unique duties, including maintaining confidentiality, avoiding conflicts of interest, operating competently, safeguarding client property and honoring the client's interests over the lawyer's.

Historically, courts have treated this area of law, attorney-client fee arrangements with special concern applying principles different from those set forth by commonplace commercial contracts so as to uphold the integrity of our legal and judicial systems. *See, Matter of Schanzer*, 7 AD2d 275 (1st Dept. 1959) aff'd 8 NY2d 972 (1960); *Martin v. Camp*, 219 NY 170 (1916).

The law requires that an agreement between an attorney and client be construed most favorably for the client. *Shaw v. Manufacturers Hanover Trust Company*, 68 NY2d 172, 177 (1986). This Court recognizes the special nature of the attorney-client relationship. Further, the Court believes that such relationships and public perception may be undermined by the unethical conduct of a lawyer.

Rhodes attempts to justify and excuse his actions by asserting that he made such disclosure as was appropriate to highly educated, worldly and sophisticated businessmen. However, this line of reasoning was specifically rejected in *Forrest Park Assocs. Ltd. Partnership v. Kraus*, 175 AD2d 60 (1st Dept. 1991), where the Court stated that "the Code of Professional Responsibility" places the burden upon counsel irrespective of the sophistication of the client, to obtain his consent after full disclosure before entering into a business transaction, such as the one in issue, where the

differing interests of counsel and the client, may interfere with the exercise of professional judgment for the client's protection.

Additionally, "for over 100 years our courts have made it clear that a transaction between a lawyer and his client will be regarded with suspicion and that it will be presumptively void, subject to proof by the lawyer, usually through disinterested persons, that the transaction was fair and fully intended by the client." *Radin v. Opperman*, 64 AD2d 820 (4th Dept. 1978). With clarity, the Court placed the burden of coming forward with clear and satisfactory evidence in these transactions, squarely on the shoulders of the attorney. Moreover, the Court further stated that "other than in exceptional circumstances, a lawyer should insist that an instrument in which his client desires to name him beneficially be prepared by another lawyer selected by the client . . . . and meticulously adhere to this principle of law." *Radin v. Opperman*, supra at 820-821.

While the full disclosure contemplated by DRS-104(A) is not specifically defined therein, an attorney should explain to the client the importance of obtaining independent counsel and insist on a memorialization of their agreement. *In the Matter of Daniel T. Coxeter and Susan J. Coxeter*, 208 AD2d 1178 1179 (3rd Dept. 1994).

This Court is unable to contemplate all of the various ways in which a conflict might arise as a result of Rhodes' failure to fully disclose their differing interests. However, the following constitutes a few:

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- Rhodes failed to inform his clients to seek independent counsel perhaps because it was not in his best interest to do so. More specifically, it is likely that independent counsel would advise against a percentage ownership of the property, as opposed to payment of services rendered based on a quantum merit basis. Such would alleviate the imbalance of equities found herein.

- Rhodes failed to advise his clients of the great potential for a lawsuit in cases the attorney is also a co-owner of a business entity.

- Rhodes failed to disclose that as a result of wearing two hats he might be rendered objectively incapable of deciding what is in the clients' best interests. For example, as the profit margin widens and the personal stakes become increased, Rhodes objectivity may become lessened.

- Rhodes is desirous of a percentage of the property interest because of the unique entrepreneurial opportunity presented and its likelihood of great success. This he fails to disclose.

- Rhodes failed to inform his clients that it might be in the client's best interests to perform particular legal services but not in his best interest, because such could substantially reduce profits and trigger hours of hard work.

- Rhodes failed to inform his clients that he was an employee at will and as such could be

terminated at any point in time, giving rise to the false perception that they had to be co-owners infinitely.

- Rhodes failed to set forth in the fee agreement what legal responsibilities he and his partners would undertake.

This list is not intended to be exhaustive of all conflicting interests contemplated. Surely, the mere fact Rhodes, Buechel and Pappas are embroiled in such complex and expensive litigation is the most demonstrative proof of their divergence in interests. Of course, hindsight is better than foresight.

Rhodes admits that upon execution of the fee agreements he failed to advise Buechel and Pappas to consult with independent counsel. Thereafter, Rhodes formalized their relationship by forming Biomedical Engineering Corporation, which issued one-third of the shares to the law firm of Bain, Gilfillan and Rhodes giving each a one-ninth interest. The Court finds that at this stage Rhodes again failed to advise Buechel and Pappas to consult independent counsel. This Court finds further that Rhodes failed to inform Buechel and Pappas of the potential conflict of interest that might arise when a lawyer enters into a business transaction with a client, at these two critical stages. First, when the initial fee agreement was signed and upon formation of the corporation.

In essence, Rhodes had converted his attorney fee which was a one-third interest in a single invention into a one-third equity interest in a corporation responsible for the exploitation of all of their future inventions. Needless to say, the

equities were not fairly balanced. The benefit to Rhodes far outweighed the value of the services rendered. Thus, compensation in the amount sought is clearly excessive. Since the relationship between a lawyer and his client is a fiduciary one, the attorney may not take advantage of his superior knowledge and position. Even in the absence of any indication of fraud or undue influence on the part of the attorney, the agreement may still be invalid "unless he can show that the client was fully aware of the consequences and that there was no exploitation of the client's confidence in the attorney." *Greene v. Greene, supra* at 92). Rhodes has failed to meet the burden set forth.

Here, the clients Buechel and Pappas maintain that they were not fully and fairly informed of the consequences of the agreement. More specifically, they were not aware that despite Rhodes' ownership interest in the business enterprise, he could be terminated as attorney. This is evidenced by the fact that they did not discharge him until he had sued them, despite the difficult working environment. A review of the record and documents in evidence supports the position of Buechel and Pappas. There purports to be no testimony or document outlining the parties' discussions in its entirety pertaining to what information was disclosed. Further, there exists no document indicating that Buechel and Pappas were advised to seek independent counsel. As such, the record is void of independent evidence corroborating the position of Rhodes.

Accordingly, the Court finds that Buechel and Pappas were never advised by Rhodes to seek independent counsel. Moreover, Rhodes exploited his clients through affirmatively pursuing a business relationship with them absent full disclosure.

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The Appellate Division stated in *Chang v. Chang*, 190 AD2d 311 (1st Dept. 1993) that:

> "An attorney may not allow his own interests to conflict with those of his client. To hold otherwise would be to ignore the overriding public interest in the integrity of our adversary system." Citing *Greene v. Greene, supra.*

The task of having to fully review the acts of Rhodes has been arduous and difficult. This Court has taken pains and taken measures to determine whether or not Rhodes committed acts unethical in nature.

In *Chang*, the Appellate Division further stated, that "Courts can never abdicate their responsibility to supervise and regulate the ethical conduct of attorneys appearing before them, especially where the rights of litigants are affected. *Id.* As such, the prohibitions of the Code of Professional Responsibility will not be transgressed. Further, this Court will not justify or excuse the unethical behavior of plaintiff Rhodes.

The Appellate Division held, in *Schlanger v. Flaton*, 218 AD2d 597 (1st Dept. 1995), that a client is entitled to rescission unless the attorney can convincingly show that the client was fully and fairly informed of the consequences of the agreement and the special advantages it gave to him.

The Courts have consistently held that it is improper for an attorney to enter into a business relationship without first advising the client of the right and advisability to seek other counsel to obtain independent advice concerning such relationships. *Matter of Richard L. Levine v. Grievance*

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Committee of the Fifth Judicial District, 64 AD2d 820, (3rd Dept. 1993). In *Matter of Richard L. Levine*, the failure to advise the client of such warranted the one-year suspension from the practice of law. In other words, courts have repeatedly viewed such a failure to act as serious misconduct.

TRUST AGREEMENTS

Since 1981, Rhodes had been aware of the significant tax liability which the shareholders of Biomedical Engineering Corporation were exposed to. Upon the suggestion of Buechel's accountant, Biomedical Engineering Corporation consulted with John Power, Esq., a New York City tax attorney. The Court specifically notes that in 1983, Biomedical Engineering Corporation retained Power. Further, on the first occasion Power met with Buechel, Pappas and Rhodes. Thereafter, on two additional occasions Power met with Buechel, Pappas and either Rhodes, Bain or Gilfillan. This is significant because it clarifies whether or not John Power, Esq. served as independent counsel to Buechel and Pappas or merely as counsel to the corporate entity.

The testimony reveals that Power was consulted by the corporation for tax advice. As such, Power was responsible for rendering a determination as to whether or not the corporate entity should be dissolved. The Court notes that Power was not hired to, nor ever asked to render a determination as to the propriety of the fee arrangement. As such, he did not evaluate the overall fairness of the business arrangement or whether or not Buechel and Pappas had been fully informed of the potential for conflict as a result of forming a business entity with their lawyer.

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Power did seek copies of documents pertaining to the origin of the relationship of the parties. However, the Fee Agreement of 1974 was not given to him. Further, Rhodes informed Power that no such document existed. After careful consideration of the tax consequences, Power suggested that the corporation be dissolved and the corporate assets transferred to a Trust, created for the benefit of its shareholders, in proportion to their respective shares. Hence, we have the creation of "Trust I" and "Trust II". Pursuant to the Trust agreement in "Trust I" Bain and Gilfillan were responsible for prosecuting and defending the patents. Rhodes was released from this obligation upon requesting so.

The presence of Power indeed complicates the issues because it appears that Power worked diligently to protect the interests of all concerned collectively, and to some extent, individually. For example, although Power was not specifically asked to review the propriety of the fee arrangement nor to consider whether or not full disclosure had been made, he did do the following:

- Power pointed out the tax errors and advised the parties to dissolve the corporate entity.

- Power informed Rhodes of the conflict inherent in his dual role.

- Power advised Rhodes to "stick to what he knows best", prosecuting and defending patents, thereby suggesting that the exposure for conflicting interests would be minimal.

- Power did not tamper with the initial fee arrangement upon the formation of Trust I and Trust II. The record reveals he was not asked to do so.

- Power transferred the corporate assets to a trust created for the benefit of the parties, in proportion to their corporate stock holdings.

- Power failed to advise Buechel and Pappas that they could discharge Rhodes and not suffer any legal recourse as a result of terminating his services until the point at which Rhodes sued Buechel and Pappas.

- Power failed to consider whether or not the fee agreement was fair and ethical in light of the circumstances.

The pivotal issue becomes whether or not Buechel and Pappas had independent counsel. If not, prior to executing the trust agreements which essentially gave Rhodes a permanent, indefeasible interest in the trust royalties that could survive his discharge were they made fully aware of the existing conflicts of interest inherent in such a business arrangement. The Court notes that with regard to fees, the Trust Agreement merely recodified the prior fee arrangements entered into.

The Court finds that notwithstanding the presence of two attorneys, Rhodes and Power, the defendants failed to be fully and adequately made aware of the potential for conflict. Power did bring Rhodes conflicting dual role to light.

However, the defendants were not made aware of the magnitude of the existing potential conflict therefore never placed in a position to fully protect their individual interests respectively. They trusted Rhodes and that trust was violated on multiple occasions.

To some extent it might be understandable why Rhodes thought the existing conflicts and potential for conflict was obviated by the presence of Power. However, this view cannot be sustained under the law. As a result of the incomplete advice of both counsel, the Court finds that the interests of defendants were not properly served. Here, despite the presence of Power, defendants were not fully informed. Under the law, it was Rhodes obligation to take affirmative measures to protect his clients. That is, to inform the defendants to seek truly independent counsel or to fully disclose to them the existing conflicting interests previously set forth. The Court finds that Rhodes failed in so doing. Moreover. Powers' presence did not cure the ethical violations noted.

Assuming arguendo, that defendants executed the Agreement which set forth their intentions and for more than 10 years thereafter acted in accordance with this agreement through their daily business activity; correspondence, telephone conversations and office meetings with Rhodes, even after the retention of Power, it does not negate the fact that they were never advised to seek independent counsel.

Moreover, assuming arguendo that defendants believed that their interests were secure until the point at which they were made aware of the tax ramifications. It does not negate the fact that they were never advised to seek independent counsel.

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Notwithstanding, the corporate dissolution and formation of the Trust I and Trust II, this Court finds that the following crucial factors were not disclosed to Buechel and Pappas. The responsibility for such disclosure beared by Rhodes.

- The inherent conflict of interest in having their patent attorneys Rhodes, Bain and Gilfillan as beneficiaries pursuant to the Trust agreements.

- Other, more suitable fee arrangements were not discussed with them, such as: hourly fixed rate, sliding scale fee, cap on royalties and compensation determined by the reasonable value of the services rendered.

- Buechel and Pappas were not informed that they should seek independent counsel.

- The conflicts inherent in giving attorneys equity interests in a corporation as payment for legal services rendered.

- Most importantly, Buechel and Pappas were not made aware of their unfettered right to discharge counsel at any time and thereby seek rescission of the trust agreement.

The Court finds that despite the fee agreement, the defendants could have discharged counsel and sought rescission because it appears that counsel "got the better of the bargain" and exploited his client's confidence. *Howard v. Murray*, 38 NY2d 695, 699 (1976); 43 NY2d 417 (1977).

In conclusion, this Court finds that Buechel and Pappas did not have the benefit of truly independent counsel and were never instructed to seek such advice. As such, the trust agreements are rescinded.

Further, with regard to the bead separation and Rhodes' use of confidential information, the Court finds that Rhodes engaged in unethical activity thereby breaching the duty owed to defendants, pursuant to N.Y. Judiciary Law Section 4-101 and 5-108(A)(2). Rhodes had a continuing duty not to disclose such information absent the client's expressed consent. Instead, he disclosed confidential information as a means of gaining leverage, and forcing a settlement of the issues presented. Further, defendant Buechel was disadvantaged as a result of the threat to his career.

COMPENSATION OF TRUSTEES

Defendants Buechel and Pappas paid themselves for research, development and marketing. Plaintiff contends that in so doing, they took unfair advantage of their role as trustees, thereby breaching their responsibilities as fiduciaries. The Court disagrees with plaintiff's contentions. The research, development and marketing of the prosthetic device developed was an essential function directly responsible for the tremendous success of the business venture. Here, the Court finds two individuals of extraordinary skill and talent, uniquely qualified to render such services, whose efforts have proven beneficial to all persons involved in the business venture. As such, their actions do not constitute prohibited self-dealing. Since the Trust agreements and the license agreements mandated such services be performed, yet was silent as to payment the Court finds that the defendants did not breach

any of their fiduciary responsibilities. To the contrary, the Court finds that the performance of their fiduciary tasks were exemplary. In any event, this issue is rendered moot by the Court's decision to rescind the trust agreements.

DISCHARGE

In January 1987, Buechel and Pappas terminated Rhodes for cause. Rhodes' discharge was triggered by the institution of a lawsuit which he brought against his clients in New Jersey. In *Campagnola v. Mulholland, Minion & Roe*, 76 NY2d 38 (1990), the Court of Appeals, in pertinent part, stated the following:

> "As we not too long ago observed '[t]he unique relationship between an attorney and client, founded in the principle upon the elements of trust and confidence on the part of the client and of undivided loyalty and devotion on the part of the attorney, remains one of the most sensitive and confidential relationships in our society.' " Citing (*Demov, Morris, Levin & Shein v. Glantz*, 53 NY2d 553, 556).
>
> Because of the role attorneys play in the vindication of individual rights in our society, they are held to the highest standard of ethical behavior (Code of Professional Responsibility, Preamble: EC 6-5). Yet without this relationship of trust and confidence an attorney is unable to fulfill this obligation to effectively represent clients by acting with competence and exercising proper care in the representation. (*Demov, Morris, Levin & Shein v. Glantz*, 53 NY2d at 556, *supra*).

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As previously noted, as a result of the uniqueness of the attorney-client relationship, traditional contract notions are often dispelled with, in an effort to achieve fairness. For example, despite the agreement entered into "a client has the absolute right to discharge an attorney at any time." *Shaw v. Manufacturers Hanover Trust Company*, 68 NY2d 172, 177 (1986); See, Code of Professional Responsibility, DR 2-110, DR 5-102, DR 5-105.

Stemming for the clients' unfettered right to discharge an attorney is the emergence of the principal that the discharge ends compensation. Where the discharge is without cause, the attorney is limited to recovering in quantum meruit the reasonable value of the services rendered, *Teichner v. W&J Holsteins* 64 NY2d 977, 979 (1985).

Where the discharge is for cause, the attorney has no right to compensation or a retaining lien, notwithstanding a specific retainer agreement, *supra.* This rule is designed with clarity "to promote public confidence in the members of an honorable profession whose relation to their clients is personal and confidential" *Martin v. Camp*, 219 NY 170, 176 (1916).

The public policy considerations which underlie judicial concerns compel this Court to deny Rhodes' compensation for unearned attorney's fees. That is, for fees accruing subsequent to his termination. As such, compensation, if any, will end as of the date of termination of services. The request for compensation for the life of the inventions, in light of the unethical actions of Rhodes, constitutes a failure to respect and to honor faithfully the fidelity owed to the client and to discharge competently the responsibilities flowing from

the engagement. *Campagnola v. Mulholland*, 76 NY2d 38, at 44 *supra*.

Despite the previously enumerated unethical actions of Rhodes, this Court cannot, in good conscience, forfeit fees in the entirety. To do so would yield an unjust result under the circumstances of this particular case. All persons involved in this joint venture (defendants Buechel and Pappas and Bain and Gilfillan) have received several millions of dollars to date. Thus, the Court, in its discretionary power, will award Rhodes the value of his legal services up until the date of discharge. That is, award compensation on a quantum meruit basis because of his diligent efforts over a lengthy period of time. Troublesome to the Court is the fact that Rhodes failed to keep time sheets reflecting services rendered. Rhodes maintains that because he charged a fee of a 1/3 interest in royalties, for the life of all patents, such a time sheet accounting was not done. The Court understands the failure to keep such records in light of the specific agreement of the parties. Thus, the following factors have been considered by this Court in determining the value of the legal services rendered by Rhodes:

- The measure of success with which Rhodes is crowned.

- The devices patented by Rhodes have grossed millions to date.

- Rhodes has worked diligently for approximately twelve years on behalf of defendants Buechel and Pappas (1974-1986).

- The first license negotiated by Rhodes provided for a very high royalty rate of 15% (the New Jersey knee).

- Defendants have received $50 million in royalties as of the date of this trial.

- Bain and Gilfillan have received $3.5 million dollars each to date.

- Rhodes worked diligently for many years in reliance on the agreement that all parties would receive their respective shares of the proceeds from the ultimate exploitation of the inventions.

- The agreement was unchallenged for many years.

- Rhodes worked on 27 patent applications, which resulted in 20 United States patents.

- Rhodes secured several foreign patents and licensing agreements.

It is well settled that an attorney who engages in misconduct by violating the Disciplinary Rules is not entitled to legal fees for any services rendered. *Matter of Winston v. Rogers & Wells*, 214 AD2d 677 (2nd Dept. 1995). The record reveals that plaintiff Rhodes violated DR5-101(a) and DR5-104(a) of the Code of Professional Responsibility (22 NYCRR 1200.20(a) and 1200.23(a)) by failing to fully disclose to his clients the potential for conflict, upon entering into a business venture with them. "Insofar as conduct which

violates the Disciplinary Rules constitutes misconduct", plaintiff is not entitled to a legal fee for services rendered. *Pessoni v. Rabkin*, 220 AD2d 732 (2nd Dept. 1995) citing *Brill v. Friends World Coll.*, 133 AD2d 729, 730 (2nd Dept. 1987).

Although the law indicates that fee forfeiture may be an appropriate remedy under the circumstances presented herein, the Court, in the interests of fairness, declines to forfeit fees in totality. This Court genuinely believes that the forfeiture of fees for the life of the various inventions is sufficient penalty for the unethical activities engaged in by Rhodes.

An important factor in determining the value of attorney's services is the measure of success with which he is crowned, i.e., the results achieved and the benefits. *Matter of Harris*, 277 AD2d 1030 (1st Dept. 1950). Unequivocally, this joint business venture has proven to be a tremendous success of unsurmountable measure greatly beneficial to persons in need of prosthetic limbs. Further, the devices patented grossed millions to date, largely the result of marketing, negotiations and its commercialization. Needless to say the joint business venture has proven to be extremely financially rewarding.

Notwithstanding, the unethical activity of plaintiff Rhodes, he has worked diligently for many years on behalf of defendants Buechel and Pappas and achieved favorable results; to wit tremendous profits, flowing from devices which he patented. As such, he too is responsible, to some extent for the success of the prosthetic devices on the market.

This Court exercises its discretionary authority in granting plaintiff judgment in the amount of one million five

hundred thousand dollars under the theory of quantum meruit, for the value of the services which he has rendered until the date of discharge. However, the Court declines to award plaintiff legal fees thereafter.

The Court agrees with the contentions of plaintiff Rhodes with regard to the counterclaims asserting malpractice. With regard to the '451 Patent, defendants assert that Rhodes failed to have claimed the original shoulder invention broadly enough, so as to afford defendant more leverage in negotiating a license from NRDC, the holder of the Goodfellow/Oxford patent. The Court finds that the claims of plaintiff for the '451 Patent application were fair and reasonable, in light of the information conveyed to Rhodes by Buechel and Pappas at the time.

Further, plaintiffs entered into a settlement agreement with NRDC. The facts fail to set forth that the settlement would not have been reached "but for" the claims of Rhodes.

With regard to the '658 Patent, the Court finds that Rhodes filed timely, in light of the fact that he had been instructed to wait until after the inventors had resolved certain important issues with DePuy and it was not until the end of 1981 that DePuy decided to accept the proposal. Additionally, the Court finds that the invention in question was different from that of the invention of Dr. Ramos. More specifically, its novel characteristics that being . . . . "the use of a self-retaining epherical joint employing segments with a ring around the segments holding them together prior to assembly," distinguished it from that of Dr. Ramos. Thus, this Court agrees with plaintiff's position that defendants could not stand in the shoes of Dr. Ramos in any litigation.

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In the infringement action of *Ramos v. Boehringer Manheim Corp.*, 861 F. Supp. 1064 (S.D. Fla 1994) aff'd 66 F. 2d 346 (Fed. Cir. 1995), the District Court held that the device sold by DePuy (the successor name of Boehringer Manheim Corp.) differed from the Ramos and Biomet. The Court further stated that "the collar is locked to the bearing insert before assembly of the hip; and the femoral ball fits into the bearing with collar attached, before the assemblage is inserted in the acetabular cup."

Thus, this Court concludes that defendants would not have obtained the same result as Ramos in the Biomet litigation. Accordingly, the malpractice claims of defendants are without merit.

STATUTE OF LIMITATIONS/LACHES

The counterclaims of defendant trustees against plaintiff attorney to rescind the trust agreements, commenced more than ten years after the creation of the trust, are not time barred, where the plaintiff continued to act as defendants' patent attorney and gave legal advice on personal matters, until plaintiff sued defendants and was discharged. Here, the Court finds that the continuous representation concerning the same or a related problem would toll the commencement of the applicable six-year Statute of Limitations for equitable causes of actions pursuant to CPLR Section 213, subd. 1. The client cannot be expected, "in the normal course, to oversee or supervise the attorney's handling of the matter, thus the client's right of action does not accrue until discharge of the attorney. *Greene v. Greene* 56 NY2d 86, 95 (1982). For the same reasoning, the Court finds that the tolling provision would be in effect until defendants were made fully aware of the conflicting interests of Rhodes.

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CONCLUSION

Accordingly, it is ordered and adjudged that judgment be entered in favor of plaintiff Rhodes as against defendants in the amount of one million five hundred thousand dollars for the value of services rendered up until the date of discharge. This amount takes into account the twelve year period that has elapsed since plaintiff's discharge and, therefore, includes any possible entitlement by plaintiff to prejudgment interest; further it is

Ordered and adjudged that the counterclaims are granted to the extent that the trust agreements are rescinded, restoring defendants to their original position prior to retaining plaintiff and in all other respects the counter-claims are dismissed; further it is

Ordered and adjudged that plaintiff's claims that defendants breached their duties as trustees is rendered moot and therefore dismissed, as the Court has rescinded the trust agreements; further it is

Ordered and adjudged that all of plaintiff's remaining claims are dismissed.

This shall constitute the verdict of the Court.

Settle judgment on notice.

Dated: March 4, 1998

s/ Richard B. Lowe III
Richard B. Lowe III
J.S.C.

APPENDIX H — JUDGMENT OF THE SUPREME COURT, COUNTY OF NEW YORK, STATE OF NEW YORK FILED APRIL 30, 1998

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 54

Index No.: 8055/87

R. GALE RHODES, JR.,

Plaintiff,

-against-

FREDERICK F. BUECHEL and MICHAEL J. PAPPAS, individually and as Trustees of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants,

-and-

JOHN N. BAIN and JOHN G. GILFILLAN, III, as beneficiaries of a certain trust entitled Biomedical Engineering Trust, and PAUL A. WITTE, as beneficiary of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants-Beneficiaries.

Appendix H

JUDGMENT

PRESENT: Hon. Richard B. Lowe, III

The issues in the above-entitled action having duly come on for trial before Justice Richard B. Lowe III, sitting without a jury from April 24, 1995 through July 10, 1995 and the plaintiff having appeared by Leventhal & Slade, and defendant Frederick F. Buechel having appeared by Solomon, Zauderer, Ellenhorn, Frischer & Sharp, and defendant Michael J. Pappas having appeared by Hawkins, Delafield & Wood, and defendant-beneficiaries John Bain and John Gilfillan, III having been represented by LeBouef Lamb Green & MacRae LLP, and defendant-beneficiary Paul A. Witte having acted *pro se*, and the allegations and proofs of the parties having been heard, and due deliberation having been had, and the Court having duly made and rendered its decision on the 4th day of March, 1998, and filed such on the 10th day of March 1998 containing a statement of facts and conclusions of law, and the Court's decision having been supplemented by a decision made on the 10th day of March 1998, now, on motion of Solomon, Zauderer, Ellenhorn, Frischer & Sharp, it is hereby

ORDERED, ADJUDGED AND DECREED that since all of the agreements which purport to provide for compensation for legal services, by the payment of money or by providing an interest in any trust, corporation or other entity, were entered into in violation of the ethical duties owed by attorneys to their clients, the relief sought in the Third Counterclaim in the Verified Amended Answer to Third Amended Complaint, dated December 16, 1991, of Buechel

and Pappas, individually and as Trustees of Biomedical Engineering Trust ("Trust I") and Biomedical Engineering Trust II ("Trust II"), is granted, thereby terminating and rescinding, *ab initio,* any interests Rhodes holds, or may have held, in Trusts I and II, and it is further

ORDERED, ADJUDGED AND DECREED that the First and Second Counterclaims asserted by defendants Buechel and Pappas in their Verified Amended Answer to Third Amended Complaint are dismissed on the ground that plaintiff Rhodes' interests in Trust I and Trust II have been rescinded *ab initio*, and it is further

ORDERED, ADJUDGED AND DECREED that the Fourth Counterclaim asserted by defendants Buechel and Pappas in their Verified Amended Answer to the Third Amended Complaint declaring that Rhodes has no interest is any patents or inventions made by Buechel and Pappas, or held by Buechel and Pappas, individually or in any trust or other entity, is granted, and the remainder of the relief sought is dismissed with prejudice; and it is further

ORDERED, ADJUDGED AND DECREED that the Fifth Counterclaim asserted by defendants Buechel and Pappas in their Verified Amended Answer to the Third Amended Complaint is dismissed with prejudice; and it is further

ORDERED, ADJUDGED AND DECREED that Counts I, II, V, and VI of Rhodes' Third Amended Complaint for alleged breach of fiduciary duty by defendants Buechel and Pappas are dismissed with prejudice, upon the finding that Rhodes' claims that defendants Buechel and Pappas breached

their fiduciary responsibilities as trustees are without merit and, further, that such claims are moot upon the finding that Rhodes' interests in Trusts I and II are rescinded *ab initio*; and it is further

ORDERED, ADJUDGED AND DECREED that Counts III (breach of contract), IV (conversion), and VII (reformation of Biomedical Engineering Trust II) of Rhodes' Third Amended Complaint are also dismissed with prejudice; and it is further

ORDERED, ADJUDGED AND DECREED that plaintiff Rhodes have judgment against Buechel and Pappas, individually and jointly, in the amount of One Million Five Hundred Thousand dollars ($1,500,000), which includes prejudgment interest, for the *quantum meruit* value of the legal services he rendered and that plaintiff have execution therefor.

ENTER

s/ Richard B. Lowe, III
Richard B. Lowe, III, J.S.C.

APPENDIX I — VERIFIED AMENDED ANSWER TO THIRD AMENDED COMPLAINT AND COUNTER-CLAIMS IN RHODES V. BUECHEL, DATED DECEMBER 16, 1991

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 14

Index No.: 8055/87

IAS PART 14
(Judge Altman)

R. GALE RHODES, JR.,

Plaintiff,

-against-

FREDERICK F. BUECHEL and MICHAEL J. PAPPAS, individually and as Trustees of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendants,

-and-

JOHN N. BAIN and JOHN G. GILFILLAN, III, as beneficiaries of a certain trust entitled Biomedical Engineering Trust, and PAUL A. WITTE, as beneficiary of certain trusts entitled Biomedical Engineering Trust and Biomedical Engineering Trust II,

Defendant-Beneficiaries.

Appendix I

VERIFIED AMENDED ANSWER TO THIRD AMENDED COMPLAINT AND COUNTERCLAIMS

Defendants, FREDERICK F. BUECHEL, M.D. ("Dr. Buechel") and MICHAEL J. PAPPAS, Ph.D., P.E. ("Dr. Pappas"), by their attorneys, POWER, WEISS & MARKS, for their Amended Answer to the Third Amended Complaint ("Complaint"), and for their Counterclaims allege as follows:

1. Deny the allegations contained in Paragraphs 8, 13, 17, 24, 26, 41, 43, 45, 46, 47, 55, 57, 59, 60, 62, 63, 69, 71, 73, 74, 75, 76, 78, 81, 83, 84, 85, 86, 90, 91 and 92 of the Complaint.

2. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraphs 1, 4, 5, 6, 18 and 19 of the Complaint.

3. Admit that Dr. Buechel is an individual and is a citizen and domiciliary of the State of New Jersey, and except as so alleged deny each and every other allegation contained in Paragraph 2 of the Complaint.

4. Admit the allegations contained in the last two clauses of Paragraph 7 of the Complaint, and except as so alleged deny knowledge or information sufficient to form a belief with regard to each and every other allegation contained in Paragraph 7 of the Complaint.

5. Refer the Court to the so-called "written agreement" and "assignment" each allegedly dated November 12, 1974, for their terms, content and import and otherwise deny each and every other allegation contained in Paragraph 9 of the Complaint.

6. Refer the Court to the so-called "written agreement" and "assignment" each allegedly dated November 12, 1974, for their terms, content and import and otherwise deny each and every other allegation contained in Paragraph 10 of the Complaint.

7. Admit that Rhodes and/or his then law firm participated in the preparation of, and on or about October 25, 1974, filed a patent application for the Floating Center Prosthetic Joint which was assigned U.S. Serial #518,161, and that the same was eventually granted approximately 1 year later on November 4, 1975 as Patent No.: 3,916,451, and except as so alleged deny knowledge or information sufficient to form a belief with regard to each and every other allegation contained in Paragraph 11 of the Complaint.

8. Admit that Rhodes and/or his then law firm filed patent applications for inventions of Drs. Buechel and Pappas, and that in connection with various of said patent applications, Rhodes and/or his then law firm performed services, including various of the services set forth in Paragraph 12 of the Complaint; deny knowledge or information sufficient to form a belief with regard to the exact number of patent applications filed by Rhodes and/or his then law firm, and except as so alleged deny each and every other allegation contained in Paragraph 12 of the Complaint.

9. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in Paragraph 14 of the Complaint and respectfully refer the Court to question of law raised therein.

10. Admit that Biomedical Engineering Corporation was incorporated in or about July 16, 1975 and that Rhodes was elected president of that corporation, and except as so alleged, deny each and every other allegation contained in Paragraph 15 of the Complaint.

11. Admit that at times during the period 1975 through 1981 Rhodes and/or his then law firm, on behalf of Drs. Buechel and Pappas, performed services in connection with the preparation and prosecution of patent applications listed in Paragraph 16 of the Complaint, and admit that the items listed in lines 1, 2, 3, 4, 7, 8, 9 and 10 in Paragraph 16 of the Complaint bear the serial numbers therein indicated and were filed on or about the dates therein indicated and except as so alleged deny knowledge or information sufficient to form a belief with regard to each and every other allegation contained in Paragraph 16 of the Complaint.

12. Admit that after Rhodes withdrew from Bain, Gilfillan & Rhodes he filed patent applications, and performed some acts of prosecution of such applications, for inventions of Drs. Buechel and Pappas, and that he continued to serve as president of Biomedical Engineering Corporation, and as president of Endomedics, Inc. and that Endomedics, Inc. was incorporated on or about October 22, 1982; and that Endomedics, Inc. was initially owned one-third each by Dr. Buechel, Dr. Pappas, and by Rhodes, and except as so alleged, deny each and every other allegation contained in the first sentence of Paragraph 20 of the Complaint.

13. Admit that at times during the period February 1982 through February 18, 1986 Rhodes and/or his then law firm,

on behalf of Drs. Buechel and Pappas, performed services in connection with the preparation and filing of certain United States and certain corresponding foreign patent applications listed in Paragraph 21 of the Complaint, and except for Item 4, the items listed in Paragraph 21 of the Complaint bear the serial numbers therein indicated and were filed on or about the dates therein indicated and except as so alleged deny knowledge or information sufficient to form a belief with regard to each and every other allegation contained in Paragraph 21 of the Complaint.

14. Deny knowledge or information sufficient to form a belief with regard to the allegations of Rhodes's knowledge and motivation as the same is alleged in Paragraph 22 of the Complaint, and except as so alleged deny each and every other allegation contained in Paragraph 22 of the Complaint.

15. Deny knowledge or information sufficient to form a belief with regard to the allegations of Rhodes's knowledge and motivation as the same is alleged in Paragraph 23 of the Complaint, and except as so alleged deny each and every other allegation contained in Paragraph 23 of the Complaint.

16. Admit that John M. Power was engaged by Biomed Corp. to counsel and recommend restructuring of the parties' relationship in an effort to minimize the negative tax consequences which the parties were currently experiencing and would continue to experience as a result of Rhodes's advice, and except as so alleged, deny each and every other allegation contained in Paragraph 25 of the Complaint.

17. Admit that Trust II was formed to receive the invention and the portion of the patent application described

in Exhibit "A" to the Trust II Agreement, and that the beneficiaries of Trust II have interests in said Trust II as set forth in the Trust II Agreement, and except as so alleged, deny each and every other allegation contained in Paragraph 32 of the Complaint.

18. Admit that only one invention was identified in the Trust II Agreement, and that proposed written assignment of inventions to Trust II were prepared by John M. Power and except as so alleged, deny each and every other allegation contained in Paragraph 33 of the Complaint.

19. With regard to the allegations contained in Paragraph 34 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18" inclusive with the same force and affect as if fully set forth herein.

20. Admit that Biomedical Engineering Corp. and DePuy, formerly a division of Bio-Dynamics, Inc. entered into a written license agreement with regard to certain prosthetic devices and respectfully refer the Court to said written agreement for the terms and conditions thereof, and except as so alleged deny each and every other allegation contained in Paragraph 35 of the Complaint.

21. Admit that the material quoted in Paragraph 36 of the Complaint is contained in page 2 of Exhibit "A" to the Complaint (the agreement forming Trust I), and except as so alleged deny each and every other allegation contained in Paragraph 36 of the Complaint.

22. Admit that the material quoted in Paragraph 37 of the Complaint is contained on pages 12-13 of Exhibit "A" to

the Complaint (the agreement forming Trust I) and except as so alleged, deny each and every other allegation contained in Paragraph 37 of the Complaint.

23. Respectfully refer the Court to Exhibit "A" to the Complaint (the agreement forming Trust I) for the terms and conditions thereof, and otherwise deny each and every other allegation contained in Paragraph 38 of the Complaint.

24. Admit that the material quoted in Paragraph 40 of the Complaint is contained on page 13 of Exhibit "A" to the Complaint (the agreement forming Trust I) and except as so alleged, deny each and every other allegation contained in Paragraph 40 of the Complaint.

25. Respectfully refer the Court to Exhibit "A" to the Complaint (the agreement forming Trust I) for the terms thereof, and otherwise deny each and every other allegation contained in Paragraph 42 of the Complaint.

26. Admit that commencing in or about mid-1986 Rhodes intermittently consented to, and objected to, certain actions of Drs. Buechel and Pappas as trustees and except as so alleged deny each and every other allegation contained in Paragraph 44 of the Complaint.

27. With regard to the allegations contained in Paragraph 48 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18", and "20" through "26" inclusive with the same force and effect as if fully set forth herein.

28. Admit that Drs. Buechel and Pappas are and always have been the trustees of Trust II, and except as so alleged deny each and every other allegation contained in Paragraph 49 of the Complaint.

29. Admit that Trust II and DePuy, formerly a division of Bio-Dynamics, Inc. entered into a written license agreement with regard to certain prosthetic device set forth in Exhibit "A" to the Trust II Agreement and respectfully refer the Court to said written agreement for the terms and conditions thereof, and except as so alleged deny each and every other allegation contained in Paragraph 50 of the Complaint.

30. Admit that the material quoted in Paragraph 51 of the Complaint is contained on page 2 of Exhibit "B" to the Complaint (the agreement forming Trust II) and except as so alleged deny each and every other allegation contained in Paragraph 51 of the Complaint.

31. Admit that the material quoted in Paragraph 52 of the Complaint is contained on pages 11-12 of Exhibit "B" to the Complaint (the agreement forming Trust II) and except as so alleged deny each and every other allegation contained in Paragraph 52 of the Complaint.

32. Respectfully refer the Court to Exhibit "B" of the Complaint (the agreement forming Trust II) with regard to the assets of Trust II, and otherwise deny each and every allegation contained in Paragraph 53 of the Complaint.

33. Admit that the material quoted in Paragraph 54 of the Complaint is contained on page 12 of Exhibit "B" to the

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Third Amended Complaint (the agreement forming Trust II) and except as so alleged deny each and every other allegation contained in Paragraph 54 of the Complaint.

34. Respectfully refer the Court to Exhibit "B" of the Complaint (the agreement forming Trust II) for the terms thereof, and otherwise deny each and every other allegation contained in Paragraph 56 of the Complaint.

35. Admit that commencing in or about 1986 Rhodes intermittently consented to and objected to certain actions of Drs. Buechel and Pappas as trustees and except as so alleged, deny each and every other allegation contained in Paragraph 58 of the Complaint.

36. With respect to the allegations contained in Paragraph 61 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18"; "20" through "26"; and "28" through "35" inclusive with the same force and effect as if fully set forth herein.

37. With respect to the allegations contained in Paragraph 64 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18"; "20" through "26"; and "28" through "36" inclusive with the same force and effect as if fully set forth herein.

38. Admit that the material quoted in Paragraph 65 of the Complaint is contained in Exhibit "A" to the Complaint (the agreement forming Trust I), and except as so alleged deny each and every other allegation contained in Paragraph 65 of the Complaint.

39. Admit that the material quoted in Paragraph 66 of the Complaint is contained in Exhibit "B" to the Complaint (the agreement forming Trust II), and except as so alleged deny each and every other allegation contained in Paragraph 66 of the Complaint.

40. Admit that in or about April of 1987, a payment in the amount of $80,987.24 was made to John Bain, a payment in the amount of $80,987.24 was made to John Gilfillan, a payment in the amount of $242,961.73 was made to Dr. Buechel and a payment in the amount of $242,961.73 was made to Dr. Pappas, and except as so alleged deny each and every other allegation contained in Paragraph 67 of the Complaint.

41. Admit that in or about August of 1987, a payment in the amount of $27,360.00 was made to John Bain, a payment in the amount of $27,360.00 was made to John Gilfillan, a payment in the amount of $82,082.50 was made to Dr. Buechel and a payment in the amount of $82,082.50 was made to Dr. Pappas, and except as so alleged deny each and every other allegation contained in Paragraph 68 of the Complaint.

42. Admit that at one or more times Rhodes, through his attorneys, made written communications to Drs. Buechel and Pappas and respectfully refer the Court to the text of such communications for the substance thereof, and except as so alleged deny each and every other allegation contained in Paragraph 70 of the Complaint.

43. Deny knowledge or information sufficient to form a belief as to the source and/or the fact of Rhodes's

knowledge, and otherwise deny each and every other allegation contained in Paragraph 72 of the Complaint.

44. With regard to the allegations contained in Paragraph 77 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18"; "20" through "26"; "28" through "36"; and "38" through "43" inclusive with the same force and effect as if fully set forth herein.

45. With regard to the allegations contained in Paragraph 79 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18"; "20" through "26"; "28" through "36"; and "38" through "44" inclusive with the same force and effect as if fully set forth herein.

46. Respectfully refer the Court to Article 32 of the Trust II Agreement for the terms thereof, and otherwise deny each and every other allegation contained in Paragraph 80 of the Complaint.

47. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in the second sentence of Paragraph 82 of the Complaint, and except as so alleged deny each and every other allegation of Paragraph 82 of the Complaint.

48. With regard to the allegations contained in Paragraph 87 of the Complaint, repeat, reiterate and reallege their responses contained in Paragraphs "1" through "18"; "20" through "26"; "28" through "36"; "38" through "44"; and "46" through "47" inclusive with the same force and effect as if fully set forth herein.

49. Deny knowledge or information sufficient to form a belief as to the truth of the allegations contained in the first sentence of Paragraph 88 of the Complaint; admit that on or about February 29, 1984 John Power wrote Rhodes a letter containing the words quoted in Paragraph 88 of the Complaint, and otherwise deny each and every other allegation contained in Paragraph 88 of the Complaint.

50. Deny knowledge or information sufficient to form a belief with regard to the allegation contained in the last sentence of Paragraph 89 of the Complaint and except as so alleged deny each and every allegation contained in Paragraph 89 of the Complaint.

AS AND FOR A FIRST AFFIRMATIVE DEFENSE

51. Rhodes fails to state a claim upon which relief can be granted.

AS AND FOR A SECOND AFFIRMATIVE DEFENSE

52. The conduct of Drs. Buechel and Pappas complained of by Rhodes was duly authorized by the respective Trust Agreements and by the applicable law of this State.

AS AND FOR A THIRD AFFIRMATIVE DEFENSE

53. Holders of more than 75% in interest of the Trust I certificates duly approved reports and/or accounts of the trustees disclosing the matters and transactions objected to by Rhodes herein.

54. Pursuant to Article 19 of the agreement creating and governing Trust I, such approval of said transactions is "final and binding" on Rhodes.

55. By reason thereof one or more of Rhodes's claims herein are without legal basis and he is estopped from asserting them.

AS AND FOR A FOURTH AFFIRMATIVE DEFENSE

56. Holders of more than 66-2/3% in interest of the Trust II certificates duly approved reports and/or accounts of the trustees disclosing the matters and transactions objected to by Rhodes herein.

57. Pursuant to Article 19 of the agreement creating and governing Trust II, such approval of said transactions is "final and binding" on Rhodes.

58. By reason thereof one or more of Rhodes's claims herein are without legal basis and he is estopped from asserting them.

AS AND FOR A FIFTH AFFIRMATIVE DEFENSE

59. Even if Rhodes were otherwise entitled to relief, some or all of the claims set forth in the Complaint are barred by the applicable statutes of limitation.

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AS AND FOR A SIXTH AFFIRMATIVE DEFENSE

60. The conduct of Drs. Buechel and Pappas was ratified by Rhodes and he is now estopped and otherwise barred from asserting claims based on such conduct.

AS AND FOR A SEVENTH AFFIRMATIVE DEFENSE

61. The Trust I and Trust II Agreements each provide at Paragraphs 24(b) thereof as follows:

The Trustees may consult with legal counsel to be selected by them, and the Trustees shall not be liable for any action or suffered by them in accordance with the advice of such counsel.

62. Any actions taken or suffered by Drs. Buechel and/or Pappas which are the subject of complaint by Rhodes were taken or suffered by them in accordance with the advice of counsel selected by them, and accordingly Rhodes is barred from asserting any claims based on such conduct.

AS AND FOR AN EIGHTH AFFIRMATIVE DEFENSE

63. Any actions taken by Drs. Buechel and/or Pappas were taken by them in good faith and in the best interests of the beneficiaries of the Trust, and accordingly, Rhodes is barred from asserting claims based on such actions.

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AS AND FOR A NINTH AFFIRMATIVE DEFENSE

64. Rhodes is barred from asserting the claims contained in the Complaint by the doctrine of unclean hands.

AS AND FOR A TENTH AFFIRMATIVE DEFENSE

65. Pursuant to the terms of the Trust I and Trust II Agreements, Drs. Buechel and Pappas have the sole discretion to select the attorney for Trusts I and II.

66. In addition, the applicable law grants Drs. Buechel and Pappas the unconditional right to select the attorney for Trusts I and II, and to discharge any attorney for Trusts I and II in their sole discretion.

67. Rhodes engaged in conduct detrimental to the interests of Trusts I and II and to such Trusts' beneficiaries and in violation of his fiduciary responsibilities to such Trusts and such beneficiaries.

68. Drs. Buechel and Pappas did not and do not wish to have Rhodes act as attorney for Trusts I or II.

69. By reason of the foregoing, and especially in light of Rhodes's wrongful conduct, Rhodes is barred from asserting one or more claims contained in the Complaint.

AS AND FOR AN ELEVENTH AFFIRMATIVE DEFENSE

70. Whatever agreement existed between Rhodes and Drs. Buechel and Pappas, if any, was breached by Rhodes's

failure to perform and/or adequately perform his obligations thereunder.

AS AND FOR A TWELFTH AFFIRMATIVE DEFENSE

71. Whatever agreement existed between Rhodes and Drs. Buechel and Pappas, if any, was breached and rendered void by reason of Rhodes's acts which were aimed at frustrating the purpose of such agreement.

AS AND FOR A THIRTEENTH AFFIRMATIVE DEFENSE

72. Whatever agreement existed between Rhodes and Drs. Buechel and Pappas, if any, was breached and/or rendered void by Rhodes's breach of his fiduciary duty to Drs. Buechel and Pappas in connection therewith.

AS AND FOR A FOURTEENTH AFFIRMATIVE DEFENSE

73. Acting in bad faith and/or without proper basis for his actions, Rhodes engaged in wrongful conduct which caused the Trusts to incur expenses which such Trusts would not have incurred but for such conduct. The aforesaid conduct includes, but is not limited to:

(a) the commencement and maintenance, without proper basis therefor, of an action in New Jersey against Drs. Buechel and Pappas, alleging breach of their fiduciary duties;

(b) the commencement and maintenance, without proper basis therefor, of the instant action;

(c) the refusal, without proper basis therefor, to turn over documents and files related to the legal matters of Trust I and II.

74. By reason of the foregoing, the Trusts incurred such expenses as attorneys fees and related costs and disbursements.

75. By reason of the foregoing, Drs. Buechel and Pappas are entitled to set off the aforesaid expenses against any moneys from the Trusts to which Rhodes might otherwise be entitled.

AS AND FOR A FIFTEENTH AFFIRMATIVE DEFENSE

76. Article 32 of the Trust II Agreement provides:

"In the event of the *incapacity*, *death* or *failure* of *Rhodes to prosecute, maintain and/or defend the Invention*, or if the *Trustees*, in their sole discretion, determine that it is in the *best interests of the Trust*, the Trustees may engage other counsel to handle such matters, *and in such event, the legal costs of such proceedings, litigation and patent maintenance, exclusive of out-of-pocket expenses, shall be charged entirely against the respective trust interest of Rhodes*. In signing this Trust Agreement, Rhodes acknowledges his obligation, at the request of the Trustees, to so prosecute, maintain and/or defend the patented Invention, or in lieu thereof to absorb the legal costs therefor exclusive of out-of-pocket expenses."

77. In or about January of 1987, Drs. Buechel and Pappas determined that it was in the best interests of Trust II to engage counsel other than Rhodes to handle the legal matters of such Trust. They accordingly discharged Rhodes as such counsel and retained other counsel.

78. By reason of the retention of counsel other than Rhodes, Trust II has incurred expenses which, pursuant to Article 32 of the Trust II Agreement, are to be charged entirely against Rhodes's interest in Trust II.

79. By reason of the foregoing, Drs. Buechel and Pappas are entitled to set off the aforesaid expenses against any moneys from Trust II to which Rhodes might otherwise by entitled.

AS AND FOR A FIRST COUNTERCLAIM ON BEHALF OF DRS. BUECHEL AND PAPPAS INDIVIDUALLY

80. On or about December 29, 1983, Rhodes, Drs. Buechel and Pappas and others entered into a certain trust agreement (hereinafter the "Trust I Agreement") pursuant to which the parties thereto created an express trust (hereinafter "Trust I"). Pursuant to the aforesaid agreement, Drs. Buechel and Pappas were named as trustees of Trust I, and Rhodes, Drs. Buechel and Pappas were, among others, named as beneficiaries of Trust I.

81. On or about February 2, 1984 Rhodes, Dr. Buechel and Dr. Pappas and others entered into a certain trust agreement (hereinafter the "Trust II Agreement") pursuant to which the parties thereto created an express trust (hereinafter "Trust II"). Pursuant to the aforesaid agreement,

Drs. Buechel and Pappas were named as trustees of Trust II, and Rhodes, Dr. Buechel and Pappas were, among others, named as beneficiaries of Trust II.

82. Drs. Buechel and Pappas repeat, reiterate and reallege the allegations contained in Paragraphs 73 and 74 hereof with the same force and effect as if fully set forth herein.

83. By reason of the foregoing, Drs. Buechel and Pappas are entitled to a judgment permitting them to set off the amount of the aforesaid expenses against any moneys from the Trusts to which Rhodes might otherwise be entitled and, in the event such expenses are greater than the moneys from the Trusts to which Rhodes is entitled, Drs. Buechel and Pappas are entitled to a judgment in their favor against Rhodes in the amount of such excess.

AS AND FOR A SECOND COUNTERCLAIM ON BEHALF OF DRS. BUECHEL AND PAPPAS INDIVIDUALLY

84. Repeat, reiterate and reallege the allegations contained in Paragraph 81 hereof with the same force and effect as if fully set forth herein.

85. At all relevant time prior to his discharge in or about January of 1987, Rhodes was counsel to Trust II and had an obligation to provide certain legal services to Trust II.

86. Repeat, reiterate and reallege the allegations contained in Paragraphs 76 through 78 hereof with the same force and effect as though fully set forth herein.

87. By reason of the foregoing, Drs. Buechel and Pappas are entitled to a judgment permitting them to set off the amount of the aforesaid expenses against any moneys from Trust II to which Rhodes might otherwise be entitled and, in the event such expenses are greater than the moneys from Trust II to which Rhodes is entitled, Drs. Buechel and Pappas are entitled to a judgment in their favor and against Rhodes in the amount of such excess.

AS AND FOR A THIRD COUNTERCLAIM ON BEHALF OF DRS. BUECHEL AND PAPPAS INDIVIDUALLY

88. At all times hereinafter mentioned Drs. Buechel and Pappas were, and still are, inventors of prosthetic devices.

89. In or about 1974 Drs. Buechel and Pappas first sought and received legal advice, with regard to the patent of their inventions, from Rhodes individually and/or his law firm ("Law Firm").

90. Commencing in 1974 Rhodes and/or the Law Firm purported to perform Services with regard to the inventions of Drs. Buechel and Pappas.

91. Beginning in or about 1974 Drs. Buechel and Pappas entered into purported agreements ("Agreements") with Rhodes, individually, and/or on behalf of his Law Firm, with regard to certain inventions of Drs. Buechel and Pappas (the "Inventions") which provided, among other things, that Drs. Buechel and Pappas would transfer to Rhodes and/or the Law Firm approximately one-third interest in the proceeds of such

Inventions and the patents thereon in exchange for which Rhodes and/or the Law Firm would perform certain legal services (the "Services") with regard to the Inventions.

92. The Agreements were unfair to Drs. Buechel and Pappas.

93. Rhodes knew that the Agreements were unfair to Drs. Buechel and Pappas.

94. Rhodes, while acting as their attorney, induced Drs. Buechel and Pappas to enter into the unfair Agreements by taking unfair advantage of his fiduciary capacity and his superior knowledge, including, without limitation, by deceiving Drs. Buechel and Pappas as to the true value of his and/or the Law Firm's Services and by failing to disclose to Drs. Buechel and Pappas that the value of the Services was disproportionately small compared to the value of the approximate one-third interest relinquished by Drs. Buechel and Pappas.

95. Rhodes served simultaneously (a) as attorney for Drs. Buechel and Pappas in connection with their entering into, amending, revising and implementing the above-mentioned Agreements between Drs. Buechel and Pappas, on the one hand, and Rhodes and/or his Law Firm, on the other hand, (b) as attorney representing various entities used to exploit the Inventions and the patents thereon in furtherance of the Agreements, (c) as the individual who had the effective control and direction of various entities used for exploiting the Inventions and the patents thereon, and (d) as an equity owner of an interest in the proceeds of the Inventions and the patents thereon and in the entities used to hold and exploit the Inventions and the patents thereon.

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96. Particularly in view of his multiple roles, as above set forth, Rhodes had compelling fiduciary responsibilities to Drs. Buechel and Pappas and to the various entities used for exploitation of the Inventions and the patents thereon.

97. In breach and violation of his duties under the Agreements, and of his fiduciary duties in connection therewith, Rhodes failed fully, properly, accurately and truthfully to advise Drs. Buechel and Pappas in connection with their entering into the Agreements, including, without limitation, as to the true and actual value of the Services to be performed, as to the right and advisability of Drs. Buechel and Pappas to seek independent legal representation in connection therewith; Rhodes failed and refused to keep Drs. Buechel and Pappas properly informed and advised as to his activities and as to the nature, progress and results of the exploitation of the Inventions and the patents thereon; Rhodes committed acts which were injurious to the interests of Drs. Buechel and Pappas and to the Inventions and the patents thereon, and to their exploitation; Rhodes committed acts, and attempted to commit acts of overreaching with regard to Drs. Buechel and Pappas and their interests, including, without full and proper disclosure to Drs. Buechel and Pappas, Rhodes performed various acts and made various proposals in connection with entering into the Agreements and with the exploitation of the Inventions which favored his own interests over the interests of Drs. Buechel and Pappas and of the entities used to exploit the Inventions; Rhodes failed to fully and adequately explain the legal and economic implications of acts proposed and performed by him in connection with the Inventions, with the patents thereon, and with their exploitation, and failed to fully and

properly explain the negative implications of such acts to Drs. Buechel and Pappas and their interests.

98. In connection with the Agreements, Rhodes represented and warranted to Drs. Buechel and Pappas that he was a highly skilled and competent patent attorney, that he was well versed and experienced in business affairs and especially in the licensing and exploitation of patents and inventions, and that the Services he would perform would be of high quality.

99. In connection with various of the Agreements, Rhodes also represented and warranted to Drs. Buechel and Pappas that his Law Firm was similarly qualified, competent and experienced in patent and business affairs, particularly with regard to the licensing and exploitation of patents, that the Services which the Law Firm would perform would be of high quality and that the resources of the Law Firm would be utilized in the performance of such Services.

10. In breach and violation of his representations and warranties, Rhodes was not highly skilled and competent as a patent attorney and well versed and experienced in business affairs, especially in the licensing and exploitation of patents and inventions.

101. In breach and violation of his representations and warranties, and primarily by reason of Rhodes's acts, the resources of the Law Firm were not made available to perform the Services.

102. In breach and violation of his representations and warranties, various Services were not of high quality and were

inadequately performed and resulted in injury to Drs. Buechel and Pappas and to the Inventions and the patents thereon.

103. Pursuant to the Agreements and in the belief that he had, and would continue to, properly and in good faith carry out his duties under the Agreements, including his duty as a fiduciary, and that he had fulfilled and carried out, and would continue to fulfill and carry out, his representations and warranties, Drs. Buechel and Pappas relinquished to Rhodes, interests in various entities established to exploit the Inventions, including interests as beneficiary of Trust I and in Trust II.

104. In entering into, amending, revising and performing under the Agreements, including those which resulted in Rhodes securing interests in Trust I and Trust II, Drs. Buechel and Pappas relied upon Rhodes's aforesaid representations and warranties, including upon his representation and their belief that he had properly and in good faith performed, and would continue to perform, his fiduciary and other duties, owed to them.

105. Rhodes's aforementioned acts were committed knowingly, improperly and without heed of his legal and fiduciary duties to Drs. Buechel and Pappas and with intent to gain personal advantage at the expense of the interests of Drs. Buechel and Pappas.

106. Pursuant to the Agreements, Rhodes received from Trust I and Trust II and from the entities formed to exploit the Inventions, designated sums of money by reason of his ownership interests in the Trusts and entities.

107. By reason of his aforesaid conduct, including, without limitation, his overreaching while a fiduciary and his breach of his representations and warranties, Rhodes's interests in Trust I and Trust II should be terminated and rescinded.

108. No adequate remedy at law exists.

109. The failure to grant such relief will cause irreparable harm to Drs. Buechel and Pappas.

110. By reason of the aforesaid acts of Rhodes, Drs. Buechel and Pappas suffered monetary damage to themselves and to the value of the Inventions and the patents thereon.

111. Drs. Buechel and Pappas should be awarded damages to compensate them for their injuries which they have suffered by reason of Rhodes's aforementioned conduct.

AS AND FOR A FOURTH COUNTERCLAIM ON BEHALF OF DRS. BUECHEL AND PAPPAS INDIVIDUALLY

112. Repeat, reiterate and reallege each and every allegation contained in Paragraphs 88 through 102, 105 through 106 and 108 through 111, inclusive, hereof, with the same force and effect as if fully set forth herein.

113. In Count III of his Complaint, Rhodes has asserted that pursuant to agreement with Drs. Buechel and Pappas, he is entitled to one-third of the profits of various other inventions of Drs. Buechel and Pappas.

114. Whatever agreement(s) existed, if any, as alleged in Count III of the Complaint, was an agreement(s) defined as "Agreements" in Paragraph 91 of this Answer and was subject to all of the terms and conditions set forth therein.

115. In entering into, amending, revising and performing under the Agreements, Drs. Buechel and Pappas relied upon Rhodes's various representations and warranties, including upon his representations and their belief that he had properly and in good faith performed, and would continue to perform, his fiduciary and other duties owed to them.

116. Pursuant to the Agreements, Rhodes received from the efforts and the entities formed to exploit the inventions which are the subject of Count III of the Complaint, designated sums of money by reason of his asserted interest in said inventions.

117. By reason of the foregoing, a declaratory judgment should issue declaring that Rhodes is not entitled to, and has no rights in various other patents or inventions in which he claims an interest in Count III of the Complaint.

AS AND FOR A FIFTH COUNTERCLAIM ON BEHALF OF DRS. BUECHEL AND PAPPAS, AS TRUSTEES OF TRUST I AND TRUST II

118. Repeat, reiterate and reallege Paragraphs 88, 89, 100 and 101, inclusive, hereof, with the same force and effect as if fully set forth herein.

Appendix I

119. In or about 1975 Biomedical Engineering Corporation ("Corporation") was formed to exploit various of Drs. Buechel's and Pappas's inventions and the patents thereon ("Trust I Inventions").

120. On or about December 29, 1983 the Corporation was dissolved and all of the Corporation's assets, rights and interests, including the Trust I Inventions, were then transferred and assigned to its shareholders who simultaneously transferred and assigned those assets, rights and interests to Trust I which became the successor-in-interest to the Corporation. Trust I continues to hold and exploit the Trust I Inventions.

121. Pursuant to the above, any and all claims of the Corporation, including those herein asserted against Rhodes, were transferred and assigned, and now belong, to Trust I as assignee.

122. On or about February 2, 1984 Trust II was formed and took assignment of all right, title and interest to a certain other invention of Drs. Buechel and Pappas ("Trust II Invention") and any patents thereon. Trust II was formed to hold and exploit, and continues to date to hold and exploit, the Trust II Invention and any patents thereon.

123. Pursuant to the above, any and all claims of the assignors of the Trust II Invention ("Assignors"), including those herein asserted against Rhodes, were transferred and now belong to Trust II as assignee.

124. Drs. Buechel and Pappas were, from the inception of Trust I and Trust II, and still are the Trustees of said Trusts.

Appendix I

125. Beginning in or about 1975, Rhodes was engaged to perform legal services for the Assignors, the Corporation and the Trusts with regard to the Trust I Inventions and Trust II Invention.

126. Rhodes accepted such engagement and undertook to perform such services with reasonable skill, care and diligence.

127. In connection with his retention as attorney, Rhodes represented and warranted to the Assignors, the Corporation and the Trusts that he was a highly skilled and competent patent attorney and that he was well-versed and experienced in business affairs and especially in the licensing and exploitation of patents and inventions, and that the services he would perform would be of high quality.

128. In connection with his retention as attorney, Rhodes represented and warranted to the Assignors, the Corporation and the Trusts that his Law Firm was similarly qualified, competent and experienced in patent and business affairs, particularly with regard to the licensing and exploitation of patents, that the services which the Law Firm would perform would be of high quality and that the resources of the Law Firm would be utilized in the performance of such services.

129. In engaging Rhodes as attorney, the Assignors, the Corporation and the Trusts relied upon Rhodes's aforementioned representations and warranties.

130. In breach and violation of his representations and warranties the Assignors, the Corporation and the Trusts have suffered damages.

131. By reason of his negligence in the performance of his duties as an attorney, the Assignors, the Corporation and the Trusts have suffered damage.

WHEREFORE, Drs. Buechel and Pappas demand judgment:

1. With respect to the Complaint, in favor of Drs. Buechel and Pappas, and against all other parties hereto, dismissing such Complaint in all respects with prejudice, and awarding Drs. Buechel and Pappas the reasonable attorneys fees, costs and disbursements of this and related actions.

2. With respect to the First Counterclaim in favor of Drs. Buechel and Pappas individually, and against Rhodes, permitting Drs. Buechel and Pappas to set off the amount of the Trust's expenses incurred as the result of Rhodes's conduct described in the First Counterclaim against any moneys from the Trusts to which Rhodes would otherwise be entitled and, in the event such expenses are greater than the moneys from the Trusts to which Rhodes is entitled, in favor of Drs. Buechel and Pappas, and against Rhodes, in the amount of such excess, together with the attorneys fees, costs and disbursements of this and related actions.

3. With respect to the Second Counterclaim in favor of Drs. Buechel and Pappas individually, and against Rhodes, permitting Drs. Buechel and Pappas to set off the amount of Trust II's expenses incurred by reason of the retention of counsel other than Rhodes against any moneys from such Trust to which Rhodes would otherwise be entitled and, in the event such expenses are greater than the moneys from such Trust to which Rhodes is entitled, in favor of Drs. Buechel, and

Pappas and against Rhodes, in the amount of such excess, together with the attorneys fees, costs and disbursements of this and related actions.

4. With respect to the Third Counterclaim in favor of Drs. Buechel and Pappas individually, and against Rhodes (a) terminating and rescinding *ab initio* any interest Rhodes may have in Biomedical Engineering Trust I, and reforming such Trust to reflect such termination and recision; (b) terminating and rescinding *ab initio* any interest Rhodes may have in Biomedical Engineering Trust II, and reforming such Trust to reflect such termination and recision; (c) directing Rhodes to return all sums which he received from the entities formed to exploit the Inventions including all sums of money received from the Trusts by Rhodes by reason of his asserted ownership interest in said Trusts; (d) awarding damages against Rhodes for injuries sustained by Drs. Buechel and Pappas in an amount to be determined but not less than $4,000,000.00.

5. With respect to the Fourth Counterclaim in favor of Drs. Buechel and Pappas individually, and against Rhodes, (a) declaring that Rhodes is not entitled to any relief requested in Count III of his Complaint, and more specifically, that Rhodes has no right or interest in any patents or inventions of Drs. Buechel and Pappas; (b) directing that Rhodes return any sums he received by reason of his asserted ownership interest in any inventions of Drs. Buechel and Pappas as set forth in Count III of his Complaint; (c) awarding damages for injuries sustained by Drs. Buechel and Pappas in an amount to be determined but not less than $5,000,000.00.

6. With respect to the Fifth Counterclaim in favor of Trust I and Trust II, and against Rhodes awarding damages for injuries sustained by Trust I, including as successor-in-interest to, and assignee of, Biomedical Engineering Corporation, and to Trust II for injuries sustained by Trust II, including as successor-in-interest to, and assignee of the Assignors in an amount to be determined, but in the aggregate not less than $6,000,000.00.

Dated: New York, New York
December 16, 1991

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APPENDIX J — CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The Supremacy Clause of the Constitution (U.S. Const., art. VI, cl. 2) provides:

> This Constitution, and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 1 of the Fourteenth Amendment states in relevant part:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law.

28 U.S.C. § 1338(a) provides:

> The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, plant variety protection, copyrights and trademarks. Such jurisdiction shall be exclusive of the courts of the states in patent, plant variety protection and copyright cases.

Appendix J

37 C.F.R. § 10.64(a) provides:

> A practitioner shall not acquire a proprietary interest in the subject matter of a proceeding before the Office which the practitioner is conducting for a client, except that the practitioner may:
>
> * * *
>
> (3) In a patent case, take an interest in the patent as part or all of his or her fee.

Supreme Court, U.S.
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No. 01-1424

IN THE

Supreme Court of the United States

JOHN N. BAIN and JOHN G. GILFILLAN, III,

Petitioners,

v.

FREDERICK F. BUECHEL, M.D. and MICHAEL J. PAPPAS, Ph.D., individually and as Trustees of certain Trusts entitled BIOMEDICAL ENGINEERING TRUST,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS, STATE OF NEW YORK

BRIEF IN OPPOSITION

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Respondents, Dr. Frederick F. Buechel and Dr. Michael J. Pappas, (collectively, "Respondents"), submit this brief in opposition to the Petition of John N. Bain and John G. Gilfillan, III, (collectively, "Petitioners") which seeks review of a decision of the Court of Appeals of the State of New York in *Buechel v. Bain* ("*Bain*"). 97 N.Y.2d 295, 2001 WL 1636938 (Dec. 20, 2001). The decision by the Court of Appeals does not warrant review by this Court.

PRELIMINARY STATEMENT

The flaw in the Petition for Certiorari is that it focuses on legal abstraction without regard for the facts of the case. The Court of Appeals decision in *Bain* confirmed unanimous decisions in two lower courts holding that Petitioners, New Jersey lawyers, acted fraudulently, in breach of their fiduciary duties, and in violation of applicable Codes of Professional Responsibility, when they induced Respondents to give them an irrevocable interest in a corporation, and, later, in a successor trust, organized to hold a variety of assets created by Respondents, including patents, license agreements, unpatented inventions and royalties. The only consideration for Petitioners' interest in these business ventures was their agreement to render all the necessary legal services for these business ventures on an ongoing, continuing, and perpetual, basis. Thus, under the fee arrangement, Petitioners were required to continually earn their equity interest in Respondents' business ventures by rendering the legal services required by those ventures. However, in violation of applicable legal principles, the fee agreement was improperly structured by Petitioners so as to provide that their equity interest would survive their discharge as counsel and their consequent failure to render any ongoing legal services to the ventures. The New York courts correctly held that this fee arrangement – which would have given Petitioners tens of millions of dollars, without requiring them to render any services in return – was unenforceable, and the courts therefore rescinded Petitioners' interests in Respondents' business.

The issue of the legality of this fee arrangement did not arise under, nor involve, the patent laws of the United States, whether in statutory form or in the form of an ethical code issued by the Patent and Trademark Office (the "PTO Code"), which governs patent practitioners when they are practicing before the Patent Office. More specifically, this case is not governed by, or even related to, the provision in the PTO Code that provides that "in a patent case" a practitioner may "take an interest in the patent as part or all of his or her fee" (App. 155a), the provision on which Petitioners rely for their claim that this case is within the exclusive jurisdiction of the federal courts. This is not a "patent case," as that term is defined in the PTO Code, and the fee arrangement between the parties did not involve "an interest in the patent" for legal services in the Patent Office. For that reason, the New York Court of Appeals properly resolved this case by applying well-established ethical rules and standards governing fee agreements, and related circumstances, in which lawyers enter into business arrangements with their clients.

Moreover, even if the PTO Code had been applicable, the Code does not, as Petitioners contend, conflict with the Court of Appeals decision in any way. To the contrary, the PTO Code includes provisions identical to the ethical provisions in New York and New Jersey applied by the New York courts in this case, which govern a lawyer's ability to enter into a business relationship with his client, the appropriate amount of a legal fee, and the unfettered right of a client to terminate his or her counsel.

Contrary to the Petition, the Court of Appeals did not effectively abolish contingent equity fees for inventors, (Pet. 9) or hold that such fees are "presumptively void." In fact, the Court of Appeals did not even address "contingent equity fees," as such, because this case does not involve a contingent equity fee. What the New York courts did address was a particular type of fee arrangement that ostensibly gave Petitioners a permanent, "*non-contingent*" equity interest in

Respondents' business, an arrangement that far exceeded in scope a single interest in a single patent for completed legal services, the arrangement contemplated by § 10.64(a)(3) of the PTO Code. For that reason, this case also does not pose "problems of federalism of enormous significance to inventors and patent lawyers throughout the country." (Pet. 1) Moreover, the Court of Appeals decision is consistent with provisions in the PTO Code itself, which establish that patent practitioners, like all lawyers nationwide, are prohibited from taking advantage of their clients as Petitioners did in this case – to wit, by inducing their clients to enter into an unfair fee arrangement, which gave the lawyers a permanent, indefeasible equity interest in their clients' business, resulted in an excessive fee for the lawyers, and penalized the clients for exercising their right to terminate their counsel, all without advising their clients of their rights. Thus, this case poses no matters of significance to patent lawyers throughout this country, is not in conflict with the PTO Code, and is not worthy of review by this Court.

Petitioners' independent claim that, in granting summary judgment to Respondents on the basis of collateral estoppel, the Court of Appeals denied them due process of law, is equally without merit and does not warrant review by this Court. Petitioners were not deprived of their opportunity to put forward any defenses they might have had to Respondents' claim for rescission of the unlawful fee agreement. As found by the Court of Appeals, the Appellate Division, and the Supreme Court of New York, Petitioners, who were joined as "essential parties" in the first of the two law suits involved herein, *Rhodes v. Buechel* ("*Rhodes*"), made a tactical decision not to participate in the first action in the hope of getting "two bites of the apple" if their former law partner, R. Gale Rhodes, Jr., lost the first case. They made this strategic choice well aware that the decision in the *Rhodes* action could determine the validity of the fee agreement. Indeed, as the Court of Appeals noted, Petitioners sought a stay of this action, pending the outcome of the *Rhodes* action, because, as they acknowledged, due to "the similarity

of the underlining facts and transactions" in the two actions, "a decision in the *Rhodes* case may estop or bar certain claims in this action." (App. 5a).

The New York courts correctly concluded that Petitioners were bound by the results in *Rhodes* under principles of collateral estoppel, because they were in "privity" with Rhodes as to the issue of the validity of the fee agreement. Rhodes was their law partner at the time the fee arrangement was created, they were co-shareholders with Rhodes in a corporation created to hold Respondents' assets, and, along with Rhodes, they were signatories to, and beneficiaries of, the successor trust at the time the *Rhodes* action was tried. The issues relating to the validity of the business arrangement were vigorously and fully litigated during a lengthy trial in *Rhodes*. Accordingly, the Court of Appeals correctly held that Petitioners were precluded from relitigating the issues already decided in *Rhodes*.

Moreover, after the decision was rendered in *Rhodes*, Petitioners were given the opportunity in this case, on cross-motions for summary judgment, to establish any reasons why they should not be precluded from relitigating the issues decided in *Rhodes*. Petitioners failed to offer any material evidence that might have established any allegedly unique defenses that had not been already decided in *Rhodes*. Therefore, there was no equitable reason to allow them to relitigate the validity of the fee agreement. In short, there is nothing unusual, controversial or questionable about the decisions of the New York courts, at three levels, applying to Petitioners the results in *Rhodes*, and the application of collateral estoppel by the Court of Appeals does not warrant review by this Court.

COUNTER-STATEMENT OF CASE

Choosing to discuss legal abstractions that are irrelevant to this case, Petitioners obscure the nature of the fee arrangement at issue, the procedural history of this case and *Rhodes*, and the bases of the holdings of the New York courts that the fee arrangement was unlawful and in violation of provisions in the Codes of Professional Responsibility applicable in New York,

New Jersey, and the Patent Office, as well, governing business transactions between attorneys and clients, the appropriate amount of fees, and the clients' right to terminate counsel. To bring this case from the abstract to the concrete, we begin with a summary of the relevant facts and procedural history of this and the *Rhodes* action.

The Inception of the Parties' Relationship and the Fee Arrangement

In 1974, Respondents, internationally known inventors of prosthetic joint implants, entered into an oral agreement with Petitioners' law firm, Bain, Gilfillan & Rhodes, pursuant to which the firm was to render legal services to Respondents in connection with the preparation and prosecution of a patent application on a prosthetic device Respondents had developed. (App. 1a, 78a-79a) In return, the law firm, which at that time was comprised of only three lawyers – Petitioners and Rhodes – was to receive a one-third interest in any income Respondents might receive in connection with that single invention. (App. 2a, 78a-79a) Less than one year later, in July 1975, in order to entrench the firm's relationship with Respondents, Petitioners and Rhodes induced Respondents to form a corporation, Biomedical Engineering Corporation ("BEC"), to exploit any of their future inventions and collect royalties on the sale of such inventions. (App. 2a, 81a-82a) Petitioners and Rhodes were given, collectively, one-third of the stock of the corporation in return for their agreement to render continuing and future legal services to the corporation, an agreement that the lawyers failed to memorialize in writing. (App. 2a, 81a-82a)

Over the course of the next seven years, Bain, Gilfillan & Rhodes performed routine legal services for BEC, the great majority of which were performed by Rhodes himself. (App. 87a) In 1981, Rhodes withdrew from the firm because of a dispute with Petitioners. (App. 2a) At about the same time, Respondents learned that the firm's earlier advice that they incorporate their business venture exposed them to unnecessary taxes on royalty income they might receive from the successful

licensing of their inventions. (App.88a-89a) Therefore, to address Rhodes' departure from the firm, and the tax problems as well, the technology created by Respondents was transferred from BEC into two trusts that replaced BEC as the vehicles for conducting Respondents' business. (App. 2a) Petitioners and Rhodes became beneficiaries of one of the trusts, Biomedical Engineering Trust (the "Trust"), and were each granted a one-ninth beneficial interest in the Trust in exchange for their agreement to render legal services to the Trust. (*Id.*) Due to the dissolution of Bain, Gilfillan & Rhodes, only Petitioners were required to continue rendering legal services on an on-going basis to the Trust.[1] (App. 90a) Significantly, the trust agreement provided that Petitioners' beneficial interests in the Trust could not be extinguished, even if they ceased providing such legal services. (App. 92a, 101a-103a)

The *Rhodes* Action and Petitioners' Role In It

In 1987, a dispute erupted between Rhodes and Respondents concerning the allocation of royalty payments to the trusts, and Rhodes commenced a lawsuit seeking to remove Respondents as trustees and for monetary relief. (App. 3a) Early in the litigation, Rhodes joined Petitioners as "necessary parties" to the action, since they, along with him, were beneficiaries of the Trust, and might be affected by the relief he sought. (App. 3a) Thereafter, in 1991, Respondents asserted counterclaims against Rhodes, who had created the fee arrangement on behalf of his firm, challenging the ethical validity of Rhodes' interest in the trusts created to hold Respondents' assets (the "Ethics Counterclaims"). (App. 3a) As the Court of Appeals explained:

> [Respondents] asserted counterclaims against Rhodes for breach of fiduciary duty and malpractice, alleging among other things that "the agreements were unfair" and that Rhodes, "while acting as their attorney induced [Respondents] to enter into the

1. Rhodes became a beneficiary of a separate trust, Biomedical Engineering Trust II, for which he alone agreed to provide the necessary on-going legal services. (App. 91a)

> unfair agreements by taking unfair advantage of his fiduciary capacity and superior knowledge, by deceiving [Respondents] as to the value of his and/or the law firm's services and by failing to disclose . . . the value of the one-third interest relinquished by the inventors."

(App. 3a)

As parties in *Rhodes*, Petitioners were on notice of the Ethics Counterclaims and their potential to nullify their interests, as well as Rhodes', in the Trusts. (App. 3a-4a, 67a) As the Court of Appeals found, Petitioners expressly acknowledged this potentiality during the pendency of the *Rhodes* action:

> Recognizing their unity with Rhodes in regard to the validity of the challenged fee arrangement, on March 12, 1992, Bain wrote [Respondents] that he was unclear as to how the counterclaims could be narrowly construed solely against Rhodes. Bain wrote that he and Gilfillan were "concerned that the counterclaims could be interpreted broadly to assert overreaching either by the law firms in which Rhodes, Gilfillan and I were involved or, at the least by Rhodes as a partner or agent of those law firms, thereby potentially extending the consequences of the alleged wrongdoing by Rhodes to Gilfillan and myself."

(App. 3a-4a) Despite the fact that Petitioners were "parties to the *Rhodes* action with notice of the issues to be decided in that case," (App. 11a), and despite Petitioners' explicit acknowledgement that the counterclaims in *Rhodes* could be construed to encompass their conduct, Petitioners, experienced lawyers, knowingly chose not to actively participate in the *Rhodes* action.[2]

---

2. However, Petitioners did, albeit selectively, participate in discovery in *Rhodes*. They "produced documents for the litigation, received copies of select documents used in the trial, (including deposition transcripts), and agreed to testify as witnesses on behalf of Rhodes before changing their minds at the last minute." (App. 12a)

In 1995, the relationship between Petitioners and Respondents became strained due to a number of disputes, including Petitioners' failure to provide competent legal services to Respondents, which resulted in the loss of certain valuable patent rights. As a result, Respondents discharged Petitioners in January 1995 and sought to amend their claims in the *Rhodes* action to assert affirmative relief against Petitioners. However, that motion was denied on the grounds that it would unduly delay the trial in *Rhodes*. (App. 4a)

The *Rhodes* Trial

The *Rhodes* action was tried in 1995. The trial involved over 5,000 pages of testimony, and hundreds of exhibits, including testimony by Professor Geoffrey C. Hazard, Jr., then Director of the American Law Institute and one of the country's leading authorities on legal ethics, and three New Jersey ethics experts, including two called by Rhodes. (App. 46a) Although the trust agreements provided that New York law was applicable to the dispute, since Rhodes and Petitioners were New Jersey lawyers, the ethics experts testified about the legal and ethical requirements of the Codes of Professional Responsibility in New Jersey and New York. In addition, the trial court heard testimony from Respondents, Rhodes and others, concerning the circumstances leading to the original 1974 fee agreement, the creation of BEC in 1975, the establishment of the trusts in 1983, and all the other relevant facts. Shortly before the trial, Petitioners entered into a "joint defense" agreement with Rhodes, and agreed to testify on Rhodes' behalf. However, during the trial, they changed their tactics and refused to appear at the last moment. (App. 12a)

In short, Rhodes, who had many millions of dollars at stake and was represented by experienced counsel, vigorously litigated the validity of the fee agreement and sought its full enforcement.[3]

3. Among other things, the trial court received in evidence an opinion by the New York City Bar Association (Ethics Opinion 80-14 (1980)) which expressly recognized that patent lawyers may receive a one-third contingent interest in their clients' patents in return for past

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The Decision in *Rhodes*

In March, 1998, the Supreme Court of New York issued a lengthy decision in *Rhodes* which contained detailed findings of fact and conclusions of law regarding the propriety of the fee arrangement. (App. 75a-118a) The Supreme Court expressly found that the fee arrangement was far more than a "proprietary interest in certain patents as the fee for prosecuting those patents on behalf of Respondents," as the Petitioners have characterized it. (Pet. 1) Rather, the *Rhodes* court held:

> Rhodes had converted his [firm's] attorney fee which was a one-third interest in a single invention into a *one third equity interest in a corporation* responsible for the exploitation of all [the clients'] future inventions.

(App. 102a) (emphasis added) In exchange for that equity interest in a corporation, whose assets were later transferred to two trusts, Rhodes and Petitioners agreed to provide all the necessary continuing and future legal services to the parties' venture. These services included – or at least were intended to include – the prosecution and defense of patent infringement actions, the negotiation of licensing agreements, and the other legal services necessary to protect and preserve Respondents' intellectual property. (App. 78a, 80a, 87a) However, the *Rhodes* court expressly found that, in connection with this arrangement, the lawyers did not properly advise Respondents of their rights. Specifically, they did not advise Respondents that, by granting their attorneys an irrevocable interest in their business, they were abridging their clients' right to freely terminate their counsel and extinguish their equity interest, which is a violation of the rule against non-refundable retainers. (App. 102a-103a) (*See In re Cooperman*, 633 N.E.2d 1069 (N.Y. 1994); *Cohen v.*

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legal services, so long as relevant disclosures are made and the interest does not create an excessive legal fee. This ethics opinion is identical in substance to inter-related provisions in the PTO Code of which Petitioners have made so much.

Radio Electronics Officers Union, Dist.3, 645 A.2d 1248 (N.J. Super. Ct. App. Div. 1994), *modified*, 679 A.2d 1188 (N.J. 1996)). Moreover, neither Petitioners nor Rhodes disclosed the conflicts of interest involved when attorneys go into business with their clients or advised the clients to consult with independent counsel regarding the propriety of the business arrangement. (App. 80a, 81a,82a-83a, 102a-103a.) Due to these many ethical violations, the court held that the fee arrangement was the product of fraud, overreaching, breach of fiduciary duty, and violated the Code of Professional Responsibility. (App. 97a-110a, 114a.) As a result, the court rescinded, *ab initio*, Rhodes' beneficial interest in the trusts. (*Id.* at 118a, 119a-122a.)

The *Rhodes* decision was unanimously affirmed by the New York Appellate Division, 685 N.Y.S.2d 65 (App. Div. 1999), and leave to appeal was denied by the New York Court of Appeals. 711 N.E.2d 984 (N.Y. 1999).

The Present Action Against Petitioners

In March 1995, before the trial in *Rhodes* began, Respondents commenced a separate action against Petitioners in the New York courts (the "*Bain* action"), in which they sought a judgment rescinding Petitioners' interests in the Trust on the same grounds on which they were seeking to rescind Rhodes' interest. In stark contrast to the position Petitioners have taken before this Court, Petitioners responded by moving to stay the action pending the decision in *Rhodes* on the ground that:

> Because of the similarity of the underlying facts and transactions in both the *Rhodes* action and this one, proceeding with this action at this time would be duplicative and a waste of judicial resources. *Indeed, a decision in the Rhodes case may estop or bar certain claims in this action.*

(App. 5a) (emphasis added). Petitioners' application for a stay was granted, and this case was held in abeyance for three years awaiting the decision in *Rhodes*. The stay was lifted when the Supreme Court rendered its decision in *Rhodes*. (App. 6a)

Respondents then moved for partial summary judgment seeking to rescind Petitioners' interests in the Trust based on the findings in *Rhodes* that the lawyers' interests in the Trust had been obtained through fraud, overreaching, and breaches of the Code of Professional Responsibility. On May 26, 1999, the New York Supreme Court ordered that Petitioners' interests in the Trust, like Rhodes', be rescinded, *ab initio*, and directed Petitioners to return $6.8 million (plus interest) that they had received from the Trust pursuant to the illegal fee agreement, (less the amount of a proper legal fee to be determined on the basis of *quantum meruit*). (App. 56a-59a, 65a-71a) The New York Appellate Division unanimously affirmed the summary judgment ruling, 713 N.Y.S.2d 332 (App. Div. 2000) (App. 40a-55a), and, thereafter, the Court of Appeals affirmed, 97 N.Y.2d 295 (2001) (App. 1a-39a)

Each of the New York courts rejected Petitioners' argument that they had been denied their opportunity to litigate the issue of the enforceability of the fee agreement. The Court of Appeals held, pursuant to the doctrine of collateral estoppel, that "[Petitioners] are barred from now once again litigating the validity of a trust agreement that was – after extensive pretrial and trial proceedings involving them – found to be invalid." (App. 9a) The Court of Appeals explained that the doctrine of collateral estoppel "is a flexible one," which requires a "case-by-case analysis of the facts and realities." (App. 9a) The Court further explained that:

> In the end, the fundamental inquiry is whether relitigation should be permitted in a particular case in light of . . . fairness to the parties, conservation of the resources of the court and the litigants, and the societal interests in consistent and accurate results. No rigid rules are possible, because even these factors may vary in relative importance depending on the nature of the proceedings . . . (*see, Staatsburg Water Co. v. Staatsburg Fire Dist.*, 72 N.Y.2d 147, 153, [1988] [citations omitted]).

(App. 9a)

Based on a fact intensive analysis, the Court of Appeals held that Petitioners were bound by the decision in *Rhodes* because, among other reasons, they were in privity with Rhodes. This determination of privity was based on

> a confluence of factors . . . including [Petitioners'] relationship with Rhodes vis-à-vis the fee arrangements, their involvement in the action, their awareness of issues that would be decided, and their acknowledged tactical decisions regarding the *Rhodes* litigation.

(App. 13a, n.*)

Petitioners' role as parties in the *Rhodes* action was an important factor in the Court of Appeals decision. The Court emphasized that since Petitioners were "parties to the *Rhodes* action with notice of the issues to be decided in that case," (App. 11a), and, indeed, had acknowledged the potential preclusive effect of that decision on their rights:

> as a policy matter, . . . a "party to a lawsuit cannot sit by idly while a contract, to which he is also a party, is judicially construed without being precluded by the result." . . . Knowing that the validity of the trust was being vigorously contested in *Rhodes*, and knowing the potential serious adverse consequences of the litigation, in this particular case it is appropriate to deem [Petitioners'] interests represented by Rhodes. [Petitioners] cannot be rewarded for their conscious tactical decision not to take a more active role in that litigation by now allowing the very same issues and facts to be relitigated. A contrary determination would undermine a policy interest that is at the heart of collateral estoppel — discouraging relitigation of issues and the potential for inconsistent outcomes.

(*Id.*) (internal citation omitted).

Petitioners' Unsuccessful Effort to Challenge the Subject Matter Jurisdiction of the New York Courts

After the New York court granted summary judgment to Respondents in this action, and nearly *eight years* after the issue of the propriety of the fee agreement was first raised in the *Rhodes* action, Petitioners first put forth their theory that the state courts lacked subject matter jurisdiction over both the fully completed *Rhodes* action and this case. Specifically, Petitioners moved to dismiss this action for lack of subject matter jurisdiction, claiming that applicable state law was entirely preempted by a single provision in a multi-provision ethics code applicable only to patent lawyers and practitioners in cases before the Patent Office. That provision, § 10.64(a)(3), provides that "in a patent case [a practitioner may] take an interest in the patent as part or all of his fee." (App. 155a)

The Supreme Court, the Appellate Division, and the Court of Appeals each decisively rejected Petitioners' jurisdictional argument. (App. 13a-14a, 53a, 60a-64a) As the Court of Appeals found:

> This case is not preempted by patent law because [Petitioners], the inventors, did not plead any substantive questions of patent law as an element of the claims asserted against defendants. A case arises under patent law "when a well-pleaded complaint establishes either that federal patent law creates the causes of action or that [Petitioners'] right to relief necessarily depends on resolution of a substantial question of federal patent law, in that patent law is a necessary element of one of the well-pleaded claims." . . . Further, Federal patent statutes do not preempt State law in this case . . . Nor do lower court decisions invalidate a patent attorney's right to receive an interest in a client's patent as full or partial payment.
>
> Rather, this case addresses the necessary disclosures attorneys must make and the ethical obligations they

> must maintain in the course of their interaction with clients. Although Federal patent law recognizes that attorneys may receive an interest in patents in lieu of traditional fee arrangements, the need for disclosure mandated by the Code of Professional Responsibility governing the practice of law in this State is not obviated.

(App. 14a) (internal citations omitted)

REASONS FOR DENYING THE WRIT

I. THE NEW YORK COURTS PROPERLY EXERCISED JURISDICTION AND HELD THE FEE ARRANGEMENT UNENFORCEABLE

The Court of Appeals correctly rejected Petitioners' argument that the PTO Code, which (a) only applies to patent lawyers and practitioners when they are practicing before the Patent Office, and (b) is no different in substance from relevant ethical rules applicable in New Jersey, New York and other states, divested the New York state courts of jurisdiction to determine the enforceability of the fee arrangement between the parties. Leaving aside the fact that this is not "a patent case" before the Patent Office, the provision on which Petitioners rely simply does not apply to the issue of the illegality of the business arrangement at bar. This arrangement gave Petitioners an equity interest in a business venture, for which Petitioners were to render continuing legal services. It did not simply involve an interest in a patent received as a fee for completed services in a "patent case." The issue of the propriety of the fee agreement raised state law questions concerning the circumstances in which attorneys may go into business with their clients. Therefore, because the resolution of this issue did not "necessarily depend[] on . . . a substantial question of federal patent law," *Christianson v. Colt Inds. Operating Corp.*, 486 U.S. 800, 808-09 (1988), it does not provide a basis for exclusive federal jurisdiction.

This case also does not implicate the Supremacy Clause because the Court of Appeals decision does not "conflict with federal law and public policy," nor does it "encumber the federal standard, [as reflected in the PTO Code] to the point of eradicating it in practice." (Pet. 11, 12) To the contrary, the PTO Code, which expressly provides that it does not preempt state law (37 C.F.R. § 10.1), is identical to the ethical standards applied by the Court of Appeals governing business relationships between attorneys and their clients, and related circumstances.

Finally, Petitioners' contention that this case "arises under" the federal patent laws also was properly rejected by the New York courts, because, like Petitioners' other arguments, it is premised on the erroneous contention that the fee agreement in this case is governed by § 10.64(a)(3) of the PTO Code.

A. Section 10.64(a)(3) of the Patent Code Is Not Applicable to this Action

Petitioners' argument that the Court of Appeals decision violates the Supremacy Clause, and that this case "arises under" the federal patent laws, is based on the erroneous assumption that § 10.64(a)(3) of the PTO Code governs this case to the exclusion of all other legal and ethical standards. The argument collapses upon examination of the parties' fee arrangement, which concerns neither the acquisition of an equity interest in a patent as a fee, the arrangement contemplated by § 10.64(a)(3) of the PTO Code, nor "a patent case," as that term is used in the PTO Code.

The decisions of the New York State courts establish that the action involves the validity of a legal fee in the form of a long-term business arrangement, which was, at all material times, that of a joint business venture for which the lawyers were to provide legal services. (App. 80a, 102a-103a) The venture originally took the form of a corporation, in which the lawyers held one-third of the stock in return for their performance of a variety of legal services. (App. 2a, 81a, 82a) Through fraudulent misrepresentations, the lawyers induced their clients to assign all their inventions and other assets to

that corporation. (App. 83a) Later, the parties' interests in the corporation were converted into interests in a business trust that purportedly would survive the lawyers' discharge as counsel. (App. 2a, 89a-91a, 105a-109a) As the New York courts properly found in *Rhodes*, Petitioners entered into this long term business venture with Respondents without adequate disclosure to them of the conflicts of interest involved, without advising the clients to seek the advice of independent counsel, without advising the clients of their unfettered right to terminate the attorneys and thereby extinguish their equity interests in Respondents' business, and through other fraudulent means. (App. 5a-6a, 80a-82a) For these reasons, the *Rhodes* court properly held that the fee arrangement – which was wholly different in nature from a single contingent equity fee for completed services – was unenforceable as a matter of law. (*See* App. 97a-105a, 109a-110a.)

In addition, the scope of Petitioners' representation of Respondents was by no means limited to practice involving "a patent case" before the Patent Office. The PTO Code expressly provides that a "patent case" is limited to the "preparation and prosecution of applications for patent[s]." *See* 37 C.F.R. §10.5 *et seq.* Here, Petitioners agreed to provide broad-based legal services to defendants, services that included – or at least were intended to include – the prosecution and defense of patent infringement actions, the negotiation of licensing agreements, and the other legal services necessary to protect and preserve defendants' intellectual property. (App. 78a, 80a, 87a) For these reasons, section 10.64(a)(3) of the PTO Code is not applicable to, much less determinative of, this action.

B. The Court of Appeals Decision Does Not Violate the Supremacy Clause Because the PTO Code Does Not Preempt State Law

Petitioners' argument that the Court of Appeals decision violates the Supremacy Clause should be rejected for the independent reason that it is based on the erroneous premise that the Court of Appeals decision "conflict[s] with federal law

and public policy" as found in the PTO Code. (Pet. 12) The PTO Code imposes ethical constraints on an attorney's arrangements with his or her client that are identical to those imposed in this case and in *Rhodes* by the New York courts. The PTO Code does not preclude inventors, such as Respondents, who have entered into an unethical or fraudulent fee agreement with patent attorneys, from suing in state court to determine their rights, or to recover for fraud, malpractice, misrepresentations, or breaches of fiduciary duty.[4] The very code on which Petitioners rely expressly declares that it does *not* preempt state law:

> This part governs solely the practice of patent, trademark, and other law before the Patent and Trademark Office. *Nothing in this part shall be construed to preempt the authority of each State to regulate the practice of law* except to the extent necessary for the Patent and Trademark Office to accomplish its Federal objectives.

37 C.F.R. § 10.1. (emphasis added)

Petitioners nevertheless contend that the PTO Code *implicitly* preempts state law, because the regulation of patent practitioners is a "general field occupied by federal law" and "the New York rules eviscerate the federal rules for all practical purposes." (Pet. 13) Petitioners are wrong in both respects.

To infer preemption of state law, a court must conclude either that: (1) Congress or a federal agency "intends that federal law occupy a given field," *California v. ARC America Corp.*, 490 U.S. 93, 100-01 (1989); or (2) the state law "actually conflicts with federal law, that is, when compliance with both federal and state law is impossible, or when the state law stands as an obstacle to the accomplishment and

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4. Petitioners concede that, as patent lawyers, who are members of the bars of New Jersey and other states, they must comply with the ethical standards applicable in those states, in addition to the ethical standards governing practice before the Patent Office. (Pet. 15, n.10) *See Kroll v. Finnerty*, 242 F.3d 1359, 1365 (Fed. Cir. 2001).

execution of the full purposes and objectives of Congress[.]" *Id.* (quotations omitted).[5]

The first criterion is not met because the Patent Office did not intend that the PTO Code "occupy the field" of regulation of patent lawyers and practitioners. As noted above, the PTO Code expressly provides that it was not intended to preempt state law. 37 C.F.R. § 10.1[6] Indeed, the Code explicitly

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5. The New York courts correctly held that Petitioners had not overcome the presumption that federal law is not intended to supersede state law regulatory schemes. *See, e.g., Environmental Encapsulating Corp. v. City of New York*, 855 F.2d 48, 58 (2d Cir. 1988). That burden is particularly high in cases that rely on the notion of an implied preemption and concern a federal regulatory scheme that involves the state's historic police powers (*e.g.*, the state's power to regulate attorneys it has admitted to practice before its courts). *See, e.g., Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. Abrams*, 899 F.2d 1315, 1319 (2d Cir. 1990), *cert. denied*, 499 U.S. 912 (1991)

> When Congress legislates in a field traditionally occupied by the States, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." . . . Thus, a litigant challenging a state statute on preemption grounds in such a field must overcome "a presumption against finding preemption of state law."

(*quoting California v. ARC America Corp.*, 490 U.S. 93, 102 (1989) and *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)); *see also Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996).

6. The Patent Office explained in its Notice of Proposed Rulemaking that the preamble to the PTO Code, 37 C.F.R. § 10.1, was proposed in light of this Court's decision in *Sperry v. State of Florida ex rel. Florida Bar*, 373 U.S. 379, 402 (1963), and to make it

> clear the PTO's intent to limit Subpart 10 solely to the practice of patent, trademark, and other law before the PTO . . . [and] to indicate that Subpart 10 shall *not* be construed to preempt the authority of any State to maintain control over the practice of law within its borders, *except* to the extent necessary for the PTO to accomplish its federal

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contemplates concurrent supervisory oversight. It requires that notification be given by those patent attorneys who have been disciplined or suspended by the PTO to "all bars of which he or she is a member." *See* 37 C.F.R. § 10.158(b)(1); 37 C.F.R. § 10.159. The PTO Code's requirement that the appropriate state disciplinary authorities be given notice of a patent attorney's misconduct makes manifestly clear that the Patent Office envisioned concurrent disciplinary jurisdiction between the Patent Office and the states.

The second criterion – that preemption can be implied when state law conflicts with federal law – also is not met. The PTO Code's acknowledgment that a patent lawyer may acquire an interest in a patent is limited by the various other provisions in the PTO Code that govern business transactions between attorneys and clients, the appropriate amount of fees, and the client's right to terminate counsel. Thus, the PTO Code provides that:

> A practitioner shall not enter into a business transaction with a client if they have differing interests therein and if the client expects the practitioner to exercise professional judgment therein for the protection of the client, unless the client has consented after full disclosure.

37 C.F.R. § 10.65. This provision is *identical* to the ethical rules imposed by the disciplinary codes of both New York and New Jersey that were the basis on which *Rhodes* and *Bain* were decided, thus destroying any notion of a conflict between the

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> objectives. These changes are being made to make clear that the PTO intends to regulate only conduct related or relevant to the practice of law before the PTO.

Practice Before the Patent and Trademark Office, Notice of Proposed Rulemaking, 49 Fed. Reg. 33,790, (August 24, 1984) (emphasis in original). *See also* Rules and Regulations, Department of Commerce, Practice Before the Patent And Trademark Office, 50 Fed. Reg. 5158, 1985 WL 90221, *5158 (February 6, 1985).

state laws and ethical rules governing this dispute and the PTO Code. *Cf.* 22 N.Y.C.R.R. § 1200.23(a); N.J.R.P.C. § 1.8(a). The PTO Code, like the ethical rules of New York and New Jersey, also prohibits a patent practitioner from collecting an excessive fee. *See* 37 C.F.R. § 10.36(a); *Cf.* 22 N.Y.C.R.R. § 1200.11(a); N.J.R.P.C. § 1.5(a), or from abridging a client's unfettered right to discharge their counsel. 37 C.F.R. § 10.40(a); *Cf.* 22 N.Y.C.R.R. § 1200.15(a)(3); N.J.R.P.C. § 1:16(a)(3).

Further, section 10.64 of the PTO Code merely codified what has long been permitted in New York, New Jersey and elsewhere. *See* Association of the Bar of the City of New York Ethics Opinion 80-14 (1980) (a lawyer may take an interest in a patent as a fee, but it may be subject to limitations on entering into a business arrangement with a client and rules against excessive fees). As noted by the PTO:

> Proposed § 10.64(a)(3) is now consistent with Informal Opinion No. 280 of the American Bar Association which states: "A lawyer may acquire an interest in a patent for his [or her] fee."

49 Fed. Reg. at 33798. Thus, rather than being in *conflict*, the PTO Code provision on which Petitioners entirely rely is in complete conformity with the state laws and principles on which *Rhodes* and *Bain* were decided.

The absence of any conflict between the PTO Code and the applicable state ethical codes and standards renders *Sperry v. State of Florida ex rel. Florida Bar*, 373 U.S. 379 (1963), and *Silverman v. State Bar of Texas*, 405 F.2d 410 (5th Cir. 1968), inapposite. In *Sperry* and *Silverman*, there were direct conflicts between the state law at issue and the patent regulations.[7]

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7. *Sperry*, for example, held that a praetitioner who limited his practice to patent work before the Patent Office was not required to be admitted to practice law in the state because the Patent Office explicitly permitted non-lawyers to practice before it. 373 U.S. at 382-83, 404. In *Silverman*, the court merely held that a state bar rule prohibiting a patent attorney from holding himself out as such conflicted with patent regulations explicitly permitting such advertisements. 405 F.2d at 414-15.

In this case, by contrast, the principles applied by the New York courts, requiring full disclosure by attorneys entering into business relationships with their clients, and precluding excessive fees and non-refundable retainers, are entirely consistent with the PTO Code.

The Federal Circuit Court of Appeals recent decision in *Kroll v. Finnerty*, 242 F.3d 1359 (Fed. Cir. 2001), is instructive. The *Kroll* court rejected the identical argument made by Petitioners that the PTO Code vests federal courts with exclusive jurisdiction to supervise a patent attorney's misconduct, and held that the New York bar was free to discipline the plaintiff, who, like Petitioners, was a member of both the federal patent bar and a state bar. 242 F.3d at 1364-65. In *Kroll*, as here, it was "beyond serious argument to suggest that [the] state action would frustrate the ability of the PTO to accomplish its federal objectives." Indeed, the court held that "by disciplining patent attorneys, who violate their ethical duties to clients, the [state disciplinary committee], would advance the goals of the patent laws by promoting better relationships between patent lawyers and their clients." *Id.* at 1365. Similarly, the decision of the Court of Appeals furthers the express objectives of the PTO Code, which preclude patent lawyers from entering into unfair business ventures with their clients, without their clients' informed consent.

In summary, there is no merit in Petitioners' contention that the New York decisions "circumscribe federally authorized patent lawyers from practicing patent law within their borders, including limiting the right to accept equity fees authorized by 37 C.F.R.§ 10.64." (Pet. 14) Rather, the Court of Appeals decision is entirely consistent with the PTO Code, and this Court's decision in *Sperry*.

C. This Case Does Not Arise Under the Patent Laws

Petitioners argue that this case vests the federal courts with exclusive jurisdiction pursuant to 28 U.S.C. § 1338(a)[8] because

8. Section 1338(a) provides, in relevant part: "The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents. . . ."

"the proper disposition of Respondents' claim, can only be determined by reference to applicable federal patent regulations, which expressly authorize patent practitioners to accept an equity interest in a patent as part or all of their fee." (Pet. 11) (citations omitted) However, since, as shown above, Petitioners' preemption argument is "'so attenuated and unsubstantial as to be absolutely devoid of merit,'" there is no basis for jurisdiction arising under the federal patent law. *Kroll*, 242 F.3d at 1366 (*quoting Hagans v. Lavine*, 415 U.S. 528, 536-37 (1974)).[9]

Moreover, while Petitioners argue that the Court of Appeals applied an "overly restrictive formulation" of the scope of 28 U.S.C. § 1338(a), they fail to cite one case in which the court held that there was exclusive federal patent jurisdiction over an issue concerning the enforceability of an agreement relating to the ownership of patents (among the other types of intellectual property assets held in the Trust). Nearly a century of case law makes it clear that disputes, which involve questions of ownership of patents, do not "arise under" the patent laws and fall within the jurisdiction of the federal courts:

> the question of who owns the patent rights and on what terms typically is a question *exclusively for state courts*. . . . [T]hat long has been the law. It is well-settled that if the patentee pleads a cause of action based on rights created by a contract, or on the common law of torts, the case is not one 'arising under' the patent laws.

Jim Arnold Corp. v. Hydrotech Systems Inc., 109 F.3d 1567, 1572 (Fed. Cir.), *cert. denied sub nom., Baker Hughes, Inc. v. Jim Arnold Corp.*, 522 U.S. 933 (1997) (emphasis added) (and cases cited therein).[10]

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9. *See also Hunter Douglas, Inc. v. Harmonic Design, Inc.*, 153 F.3d 1318, 1328 (Fed. Cir. 1998), *cert. denied*, 525 U.S. 1143 (1999) ("'wholly insubstantial and frivolous' claims do not merit federal jurisdiction") (quoting *Bell v. Hood*, 327 U.S. 678, 682-83 (1946)).

10. The cases Petitioners have cited are not to the contrary, because, unlike here, those cases did raise issues *requiring* the application of the

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Since the issue of the legality of Petitioners' equity interest in Respondents' business does not implicate, let alone "necessarily depend on," "a substantial question of federal patent law," *Christianson*, 486 U.S. at 808-09, there is no basis to review the Court of Appeals decision on the issue of subject matter jurisdiction.

II. THE NEW YORK COURTS CORRECTLY PRECLUDED PETITIONERS FROM RE-LITIGATING THE ISSUE OF THE ENFORCE-ABILITY OF THE FEE AGREEMENT

Petitioners contend that they were denied due process when the New York courts applied to them findings of fact and conclusions of law made in *Rhodes*, and they argue that the Court of Appeals "applied preclusion principles offensively to estop Petitioners from mounting any defense whatsoever to the claims asserted against them." (Pet. 2) This Court long ago held that the due process clause requires "notice and opportunity for hearing appropriate to the nature of the case." *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950). However, "there is involved in [the due process clause] no right to litigate

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federal patent law. The cases either required the resolution of a patent infringement issue – *see 3D Sys., Inc. v. Aarotech Labs, Inc.*, 160 F.3d 1373 (Fed. Cir. 1998); *Scherbatskoy v. Halliburton Co.*, 125 F.3d 288 (5th Cir. 1997); *Alco Standard Corp. v. Tennessee Valley Authority*, 808 F.2d 1490,1494 (Fed. Cir. 1986), *cert. dismissed*, 483 U.S. 1052 (1987) – the validity and enforceability of a patent – *Hunter Douglas, Inc., supra.*, 153 F.3d at 1330 – the PTO's exercise of its administrative authority to issue patents, or vest title in a patent to the United States, rather than the inventor – *see Morganroth v. Quigg*, 885 F.2d 843 (Fed. Cir. 1989); *Cedars-Sinai Medical Center v. Watkins*, 11 F.3d 1573 (Fed. Cir. 1993); *Dubost v. United States Patent & Trademark Office*, 777 F.2d 1561 (Fed. Cir. 1985) – or the review of a determination by the PTO that a particular attorney was ineligible to practice before it – *see Franchi v. Manbeck*, 972 F.2d 1283 (Fed. Cir. 1992); *Jaskiewicz v. Mossinghoff*, 802 F.2d 532 (D.C. Cir. 1986); *Wyden v. Commissioner of Patents & Trademarks*, 807 F.2d 934 (Fed. Cir. 1986).

the same question twice." *Baldwin v. Iowa State Traveling Men's Ass'n.*, 283 U.S. 522, 524 (1931).

Petitioners were not deprived of their due process rights in this case because they, in fact, had two opportunities to challenge Respondents' claims that the fee arrangement was illegal and unenforceable, first in the *Rhodes* case, in which they were named as "essential parties" and in privity with Rhodes, and then in this case. It was for those reasons that the Court of Appeals properly held, under the equitable doctrine of collateral estoppel, that, having been *both* parties in the first action *and* in privity with Rhodes, Respondents were precluded from relitigating the issues resolved in *Rhodes*.

A. Petitioners Were Properly Bound by The Decision in *Rhodes* by Virtue of Having Been Parties to that Action.

This Court has explained that:

> [a] fundamental precept of common-law adjudication, embodied in the related doctrines of collateral estoppel and *res judicata*, is that a "right, question or fact distinctly put in issue and directly determined by a court of competent jurisdiction . . . cannot be disputed in a subsequent suit between the same parties or their privies."

Montana v. United States, 440 U.S. 147, 153 (1979) (quoting *Southern Pacific R. Co. v. United States*, 168 U.S. 1, 48-49 (1897)). "Collateral estoppel . . . has the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation." *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 (1979). *See also Montana*, 440 U.S. 153-54 ("To preclude parties from contesting matters that they have had a full and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions.")

The doctrine of collateral estoppel under New York law is identical to the doctrine as defined by this Court. It "precludes a party from relitigating in a subsequent action or proceeding an issue raised in a prior action or proceeding and decided against that *party or those in privity*." *Ryan v. New York Tel. Co.*, 467 N.E.2d 487, 490 (N.Y. 1984) (emphasis added). *Cf. Richards v. Jefferson Cty.*, 517 U.S. 793, 797-98 (1996); *Montana*, 440 U.S. at 153. Since Petitioners were parties in *Rhodes*, with actual notice that Respondents were challenging the legality of the lawyers' fee arrangement with Respondents in its entirety, *a fortiori*, they are bound by the findings in *Rhodes* under both New York and federal law.

Moreover, as the Court of Appeals observed, collateral estoppel is an equitable doctrine "grounded in the facts and realities of a particular litigation." (App. 8a, 9a) (*citing Staatsburg Water Co. v. Staatsburg Fire Dist.*, 572 N.E.2d 754 (1988)). As parties in *Rhodes*, Petitioners were well aware of the proceedings therein, but engaged in a tactical gambit whereby they would take advantage of any decision upholding the fee agreement, but seek to avoid the decision, and get a "second bite at the apple," if the decision were adverse. (App. 11a, 13a; *see also* 53a, 68a). The record is clear that Petitioners knew that the decision in *Rhodes* might determine their own rights with respect to their fee agreement, and that they could be bound by the result in *Rhodes*. Indeed, they sought a stay of this lawsuit pending the decision in *Rhodes* based on their own argument that "a decision in the *Rhodes* case may estop or bar certain claims in this action." (App. 5a) It was only *after* the *Rhodes* court found that the fee agreement was unenforceable, that Petitioners claimed that the findings in *Rhodes* should not be applied in this action. It was based on these facts that the Court of Appeals concluded:

> [I]t is appropriate to deem [Petitioners'] interests represented by Rhodes. [Petitioners] cannot be rewarded for their conscious, tactical decision not to take a more active role in that litigation by now

> allowing the very same issues and facts to be relitigated.

(App. 11a)

The decision before the *Rhodes* trial denying a motion by Respondents to amend their pleading to assert specific claims for damages and equitable relief against Petitioners does not alter this result. Petitioners erroneously contend that this decision "freed [them] of liability." (Pet. 29) However, as the Court of Appeals properly held: "All that denial of the motion to amend guaranteed was that [Petitioners] would not be subject to a monetary judgment in the *Rhodes* action." (App. 13a) To obtain such a judgment, Respondents had to commence a separate proceeding against Petitioners, which they did by bringing this case.

It was in this case that Petitioners were given a second opportunity to challenge Respondents' claims by submitting affidavits showing any facts which might make it inequitable to apply to them the rulings in *Rhodes* regarding the validity of the fee agreement. They submitted eight affidavits, all to no effect, because, as the court held,

> judging by the context of [Petitioners'] affidavits in the present action, their testimony in the *Rhodes* action, even assuming its veracity, would not have met the standard of professional conduct applied in the [*Rhodes*] case, having failed to allege, *inter alia*, that plaintiffs were informed their attorneys could be replaced without penalty.

(App. 69a; *see also* 7a) Thus, under the facts presented here, the Court of Appeals properly applied the equitable doctrine of collateral estoppel.

B. Petitioners Were Also Properly Bound By the Decision in *Rhodes* Because They Were in Privity with Rhodes

Petitioners also claim that the Court of Appeals erred by allegedly basing its determination that Petitioners were in "privity" with Rhodes solely on the "commonality of interest" they shared. Petitioners argue that the Court of Appeals

application of the doctrine of "privity" does not meet the constitutional standards of due process.

Petitioners misconstrue the Court of Appeals decision, which expressly stated that its determination of privity was based on "a confluence of factors . . . including [Petitioners'] relationship with Rhodes vis-à-vis the fee arrangements, their involvement in the action, their awareness of issues that would be decided, and their acknowledged tactical decisions regarding the *Rhodes* litigation." (App. 13a, n.*) In addition to these factors the Court of Appeals further emphasized that Petitioners were in privity with Rhodes because their rights derived from a single, indivisible fee arrangement Rhodes negotiated, as their law partner, on their collective behalf:

> [Petitioners] were in privity with their former law partner, Rhodes, . . . for purposes of litigating the validity of their fee arrangements as embodied in the trust . . . [because their] rights to receive payments were coextensive with Rhodes and derived from the identical arrangement entered into when the three were law partners. . . .

(App. 10a) Thus, Petitioners' relationship as "privies" of Rhodes was based on more than a shared interest in upholding the fee arrangement. They were partners at the time the fee arrangement was created,[11] their rights and obligations derived from that identical arrangement and, as the Appellate Division held, and Court of Appeals confirmed, their "right to receive trust income stands or falls with the contract." (*Id.*)

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11. As Rhodes' partners, Petitioners are liable for his misconduct in negotiating the illegal agreement, particularly since they were the beneficiaries of his misconduct. Under New Jersey law, where Petitioners and Rhodes were partners, "[i]t is fundamental that every member of a partnership is jointly and severally liable for torts committed by other members of the partnership acting within the scope of the firm business, even though they do not participate in, or ratify, or have knowledge of such negligence or legal malpractice." *Falzarano v. Leo*, 635 A.2d 547, 550 (N.J. Super. Ct. App. Div. 1993) (citing *Malanga v. Manufacturers Cas. Ins. Co.*, 146 A.2d 105 (N.J. 1958); N.J. Stat. Ann. § 42:1-15).

Richards, *supra*, and the other federal circuit precedent on which Petitioners rely, *Tice v. American Airlines, Inc.*, 162 F.3d 966 (7th Cir. 1998), *cert. denied*, 527 U.S. 1036 (1999), and *Becherer v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 193 F.3d 415 (6th Cir. 1999), have no bearing on this case. All of those cases concerned a "common-law kind of class action," *Tice*, 162 F.3d at 972, where a party was attempting to bind a broad class of litigants to a judgment in a prior action concerning a matter of public concern, even though the first action had not been brought on behalf of a class. Not surprisingly, the courts held that a mere commonality of interest with the litigants in the first action was not sufficient to meet the requirements of due process.

For instance, *Richards* involved two classes of taxpayers (the "*Richards* plaintiffs"), who sought to challenge the constitutionality of a county tax provision that had withstood a similar attack by three taxpayers in a prior litigation. This Court held that the *Richards* plaintiffs could not be precluded under the doctrine of *res judicata* because the *Richards* plaintiffs were "best described as mere 'strangers'" to the taxpayer litigants in the first action, they had not been given notice of that first action and the first action had not been brought on behalf of a class of taxpayers. 517 U.S. at 799-802.[12] Similarly, in *Tice*, the plaintiffs were American Airlines pilots, who were challenging certain of the airline's employment policies. The court held that they could

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12. *Richards* involved the broader doctrine of claim preclusion, which bars relitigation "not only of matters litigated and decided by it, but as to all relevant issues which could have been but were not raised and litigated in the suit." *Heiser v. Woodruff*, 327 U.S. 726, 735 (1946). In contrast, in this case, the Court of Appeals held that Petitioners were only precluded by the narrower doctrine of issue preclusion, which prevented them from relitigating only those precise issues that had been resolved in *Rhodes*. Thus, Petitioners were given the opportunity to – and did – assert affirmative defenses in this case that had not been asserted in *Rhodes*. However, the court held that Petitioners failed to raise an issue of material fact as to those defenses in response to Respondents' motion for summary judgment.

not be bound by prior litigation brought on behalf of other individual pilots, *not a class of pilots*, simply because they shared some, but not all, common interests. The court observed, that, unlike a "properly certified class action," the *Tice* plaintiffs did not have "adequate notice and (at a minimum) an opportunity to opt out of an earlier [litigation]." *Tice*, 162 F.3d at 972. *Becherer* raised a similar issue: whether a class of plaintiffs (the "Florida plaintiffs") could be bound by a judgment in a prior class action, despite that the Florida plaintiffs had only joined the class of plaintiffs in the first action as to certain discrete issues. The court held that it would violate Fed. R. Civ. P. 23 to bind the Florida plaintiffs on other issues that had not been certified as class issues simply because their "interests were identical" and they had a "'sufficiently close'" relationship to the class in the first action. *Becherer*, 193 F.3d at 419, 422.

The contrast between these cases and the present dispute is stark. Petitioners were not mere "strangers" to the *Rhodes* case with no notice of the matters being litigated and the potential effect of such litigation on their rights. They were parties on notice of the issues that were being litigated, they participated in the action, and they acknowledged to the court in New York the potential preclusive effect of a decision in *Rhodes* on their rights.[13] All of the factors required by the "normal privity analysis" are satisfied. *See Tice*, 162 F.3d at 973.

There is no reason to review the Court of Appeals decision with regard to collateral estoppel because Petitioners' right to due process was fully protected by the New York courts.

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13. Petitioners argue that there was no privity between them and Rhodes at the time of the trial in *Rhodes*, because their relationship with Rhodes had become "hostile and acrimonious by the time that Rhodes commenced the Rhodes action . . .". (Pet. 26, n.11) This notion of privity is far afield. At the time of the *Rhodes* trial, Rhodes and Petitioners were co-beneficiaries of a single trust agreement that reflected a single fee agreement negotiated in 1974 when they were partners. The validity of the fee agreement, and the lawyers' interest in the business trust, was a single issue that created privity.

CONCLUSION

For the reasons set forth above, the Petition for Writ of Certiorari should be denied.

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IN THE

Supreme Court of the United States

JOHN N. BAIN and JOHN G. GILFILLAN, III,

Petitioners,

v.

FREDERICK F. BUECHEL, M.D., *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE COURT OF APPEALS, STATE OF NEW YORK

REPLY BRIEF

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Petitioners John N. Bain and John G. Gilfillan, III (collectively, "Petitioners") submit this brief in further support of their petition for a writ of certiorari to review a decision of the Court of Appeals of the State of New York (the "Court of Appeals") that raises two issues of national significance worthy of review by this Court. The first concerns whether the courts below have impermissibly intruded upon federal authority and federal jurisdiction while the second implicates due process principles at the heart of the American judicial system.

If the decisions below are allowed to stand, patent lawyers practicing patent law and their clients will no longer be subject to and enjoy the uniform rights and standards of the PTO Code, 37 C.F.R. § 10.20, *et seq.* They will find their Section 10.64 patent fee arrangements re-characterized as a "business venture" and prohibited under state law. Patent fee arrangements will be subject to a balkanized scheme of regulation, whereby federally sanctioned agreements could be valid in some states but not others, based only on the vagaries of local law or procedure.

PRELIMINARY STATEMENT

Respondents open their brief with the allegation that the Petition "focuses on legal abstraction without regard for the facts of the case." Brief in Opposition ("Opp. Br.") at 1. This assertion is highly ironic because, in fact, there are no "facts of this case" at all. *This case* has never been tried. The New York courts refused to hold a trial. Instead, they deemed Petitioners bound to an adjudication of a prior action in which Petitioners were expressly relieved of liability by the denial of a motion to amend the complaint to bring causes of action against them.

Rather than concede that federal regulations expressly permit an equity fee for patent representation like the one at issue here, Respondents highlight the supposed "facts of the case" to characterize their fee arrangement as a "business deal" or as "a long-term business arrangement." But, *by their very nature* equity fees involve long-term financial interests in the

proceeds of a patent. This ignorance of the obvious is indicative of the weakness of Respondents' entire position on the legal issues. Thus, Respondents pick and choose excerpts from a *prior* trial against *someone else* to deflect attention from the manifest validity of Petitioners' fee arrangement under federal law.

If and when Petitioners get a day in court they will be able to rebut all of the mischaracterizations of the fee arrangements that Respondents have extracted from the record in the prior *Rhodes* action. For now, however, all that is relevant is that: (1) federal law expressly permits equity fees; (2) this case is an attack on a patent-related equity fee; and (3) this case belongs exclusively in federal court as a jurisdictional matter.

By attempting to trump the black-letter law of jurisdiction with the supposed "facts of this case," Respondents also demonstrate the critical significance of Petitioners' due process appeal. Petitioners dispute all of the characterizations of the fee arrangements put forth by Respondents, but Petitioners have never been able to have their case heard. Petitioners would have tried *their* case had the motion to amend been granted. They would have been heard. But the motion to amend was denied, and Petitioners, naturally, went home.

But for the denial of due process, Petitioners would have proven that their fee arrangement was lawful, indeed fairly typical. They would have proven that they rendered good service in a patent case for a fair fee. They would have proven that it was their clients, not them, who manipulated the legal system for illicit profit. They would have proven, in short, that all of the "facts of this case" that form the bases for Respondents' opposition are not facts at all.

Petitioners contend that it is a *prima facie* and irrefutable denial of due process for a court to deny a motion to amend (on prejudice grounds no less), and then later bind the defendants relieved of liability by that denial to the outcome of the case they exited. This Court should not permit the perpetuation of

those errors in reliance on an opposition brief that would bootstrap a failure of due process below into the "facts of the case" here.

FURTHER REASONS FOR GRANTING THE WRIT

I. This Is The Appropriate Case To Determine Whether A State Court Applying State Law Has The Jurisdiction And Authority To Invalidate An Equity Fee Agreement That Is Sanctioned By 37 C.F.R. § 10.64

The Code of Federal Regulations provides, in relevant part, that Petitioners, as patent practitioners, may: "In a patent case, take an interest in the patent as all or part of his fee." 37 C.F.R. § 10.64(3). The Court of Appeals ruled that federal patent law gives a "patent attorney the right to receive an interest in a client's patent as full or partial payment . . . [but] the need for disclosure mandated by the [New York] Code of Professional Responsibility governing the practice of law in this state is not obviated." App. 14a. Thus, PTO-regulated patent attorneys, like Petitioners, who practice patent law in New Jersey (or in any other state) and service New Jersey-based clients, like Respondents, must follow the draconian disclosure requirements of the New York Code of Professional Responsibility (found nowhere in federal law) lest their equity fee arrangements be declared invalid decades later by New York courts. That decision should not go without review by this Court.

It cannot be disputed that New York law, as articulated below, imposes additional burdens found nowhere in federal law. According to the state courts below, for a federally sanctioned fee agreement to be upheld by a New York state court, the patent attorney must have made detailed disclosures of: the so-called inherent conflict between clients and their equity fee counsel; the alleged great potential for a lawsuit between clients and their equity fee counsel; the purported loss of objectivity by the equity fee counsel; the equity lawyer's profit motive. App. 98a-102a. On top of that, the New York courts have ruled that patent attorneys must insist that

their clients engage the services of independent counsel to scrutinize the equity fee arrangement. *Id.*

Petitioners submit that New York's far-reaching disclosure requirements are in conflict with the letter and spirit of (and effectively nullify) the PTO Code — whose objective is to assist the cash-starved inventor's effort to secure patent counsel, not require the engagement of a second lawyer to look over the shoulder and endorse the fee arrangements of the first. Neither the PTO nor any federal court has ever imposed such requirements on a federal patent attorney's fee arrangement. Whether the New York courts' belief and Respondents' contention that the New York Code and the PTO Code are "the same" has never been tested before the PTO or a federal court, where such a question belongs. In any event, the New York courts' holding that equity fees are "of dubious propriety" would appear to answer that question.

The determination of whether Petitioners' conduct satisfied the requirements of the PTO Code should and can appropriately be made only by the federal courts, pursuant to 28 U.S.C. § 1338. Federal jurisdiction under Section 1338 extends to any case in which the plaintiff's right to relief depends upon a substantial question of federal patent law, including where some rights or interest will be defeated or sustained by a construction of federal patent law. *See Christianson v. Colt Ind. Operating Corp.*, 486 U.S. 800, 808-09 (1988); *Helfgott & Karas, P.C. v. Dickerson*, 209 F.3d 1328, 1334 (Fed. Cir. 2000); *Franchi v. Manbeck*, 972 F.2d 1283, 1286 (Fed. Cir. 1992). Here the court below concedes that Section 10.64 applies. *See* App. 14a. It should have conceded its lack of jurisdiction at that point as well. Instead, it held that the New York Code also applies — a holding that depends on a construction of the PTO Code, a matter Congress has delegated exclusively to the federal courts.[1] *See* 28 U.S.C. § 1338.

1. More precisely, the Federal Circuit is the court Congress has charged with the obligation to promote uniformity in the field of patent

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Respondents characterize Petitioners' equity in their patents (which eventually took the form of shares of a trust for tax reasons) taken in lieu of a cash fee, as a "joint business venture." This is an erroneous conclusion of law that Respondents' brief casts as "fact." This characterization ignores that the New York courts held the fee agreement void *ab initio*, *i.e.*, before it was in a corporate or trust form and when the only agreement was that Petitioners would prosecute a patent on Respondents' "floating center prosthetic joint" invention in exchange for equity in that patent. *See* App. 1a-2a. Further, an equity fee is *always* an ongoing interest in a "business" in the sense explicitly permitted by Section 10.64 — a mutual interest in the proceeds of the underlying inventions.[2] The characterizations and forms of the actual interest are beside the point. The Court should hear this case to determine whether the validity of that equity fee arrangement under Section 10.64 is — or is not — a question

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law, responsibility to decide what patent law permits and prohibits, and the "only appellate court with the right and obligation to determine the extent that federal patent laws preempt state law." *Midwest Indus v. Karavan Trailers, Inc.*, 175 F.3d 1356, 1360-61 (Fed. Cir. 1999); *see In re Indep. Serv. Orgs. Antitrust Litig.*, 203 F.3d 1322, 1322-1324 (Fed. Cir. 2000). In this case, the New York courts overstepped whatever *de minimis* responsibilities they may have in the Congressional scheme for the regulation of patent law and its practice.

2. Respondents' contention that Section 10.64's express authorization of the fee arrangement with Petitioners is inapplicable because Petitioners ultimately agreed to provide legal services beyond simple patent prosecution services makes no sense in logic or law. Respondents' position would lead to the absurd result that patent practitioners who agree only to prosecute patents on behalf of their clients may receive an equity fee but practitioners who agree to prosecute that patent and then protect it may not, unless he charges an additional cash fee. Thus, remarkably, Respondents would penalize patent attorneys who agree to provide their cash starved clients with additional services. There is nothing in the letter or spirit of the PTO Code to suggest that Congress intended that such a limit be placed on the relationship between patent attorneys and their clients.

that can be decided by the state courts and by reference to the New York Code. Petitioners submit that it cannot. The implications for patent practitioners and notions of federalism are manifest. This is the case in which the Court should provide guidance to the lower courts on the appropriate division of labor between state and federal courts on these increasingly common fee arrangements.

It has been decades since the Court last spoke on the proper and respective roles of the states, the PTO and the federal courts in the regulation of the conduct of patent attorneys and their relationships with their clients in *Sperry v. State of Fla. Ex rel. Fla. Bar*, 373 U.S. 379 (1963). In *Sperry*, the Court was clear that states are preempted from regulating the practice of federal patent practitioners and taking action against them in a way that restricts their ability to perform federally sanctioned actions. The decision below empowers the state courts to do just that, by invalidating equity fee arrangements expressly authorized by federal law as a mechanism to provide cash-starved inventors with patent counsel.

Petitioners respectfully submit that it is time for the Court to re-visit how much state regulation of the equity fee arrangements between patent attorneys and their clients, if any, is appropriate in light of Section 10.64 and the federal policies embodied in the patent law and its practice.

II. This Is The Appropriate Case To Affirm That The Principles Of Due Process Articulated And Applied In *Richards v. Jefferson County* And Its Progeny Preclude State Courts From Applying Collateral Estoppel On The Basis Of A Common Interest

The due process concerns in this case range from acute and particular (*see* Part II.A, *infra*) to acute and universal (*see* Part II.B, *infra*).

A. Application of Collateral Estoppel To Petitioners — Successful Litigants In *Rhodes* — Is A Due Process Violation

Respondents attempted to litigate the validity of Petitioners' fee arrangement (their claim in this case) in the *Rhodes* action and lost. The *Rhodes* trial court denied Respondents' motion to assert a claim to invalidate the fee arrangement against Petitioners. *See* App. F. Respondents went on to try the validity of Rhodes' fee arrangement in the *Rhodes* action against Rhodes alone. *See* App. G.

Petitioners prevailed in the *Rhodes* case. On grounds of tardiness, prejudice and inability to take discovery, Petitioners defeated the motion to amend. Respondents did not appeal. Under most case law that speaks to this subject, including New York federal court cases, that was enough to bar subsequent litigation against Petitioners. *See, e.g., Landscape Props., Inc. v. Whisenhunt*, 127 F.3d 678, 683 (8th Cir. 1997) ("It is well settled that denial of leave to amend constitutes *res judicata* [against plaintiffs] on the merits of the claims which were the subject of the proposed amended pleading."); *EFCO Corp. v. U.W. Marx, Inc.*, 124 F.3d 394 (2d Cir. 1997); *King v. Hoover Group, Inc.*, 958 F.2d 219, 222-23 (8th Cir. 1992); *Huck on Behalf of Sea Air Shuttle Corp. v. Dawson*, 106 F.3d 45, 49-50 (3d Cir. 1997); *Walton v. Eaton Corp.*, 563 F.2d 66 (3d Cir. 1977). The courts below, however, inverted the traditional approach and held that even though Petitioners won, their former partner lost, and thus, so did they.

Respondents cite general formulations of the doctrine of collateral estoppel that emphasize "notice" and a "fair opportunity to litigate." Respondents' Br. at 27. We agree with those general formulations. Here, however, Petitioners had notice of the claim against their former partner, but operated under assurances from Respondents that no action would be brought against them. In 1995 that changed with the filing of the motion to amend. After Petitioners prevailed on that motion,

they had notice *from a court* that their rights would not be litigated in *Rhodes*, and perhaps not be litigated ever. They went home, only to be accused later of a "conscious, tactical decision not to take a more active role in that litigation." Opp. Br. at 25, *quoting* App. 11a.

Petitioners submit that the treatment of this issue by Respondents and the New York Court of Appeals is altogether too facile. It is not sufficient to say that the denial of the motion to amend meant nothing of substance — *i.e.*, only that a monetary judgment would not be entered against Petitioners. The case law says otherwise, and equally important, the motion to amend was denied on *grounds of discovery prejudice*.[3] To bind Petitioners later is far *more* prejudicial. Respondents have no answer for this.

Most important, the case law on "notice" and "fair opportunity to litigate" is grounded in practical realities. The *Rhodes* court did not say "motion denied but watch out because we may bind you anyway." No, the *Rhodes* court gave "notice" that the *Rhodes* action was *not* an action against Petitioners Bain and Gilfillan. To retroactively construe it to be an action against them, on grounds of "privity," "notice," "opportunity" or whatever, is to distort constitutional principles beyond all recognition.

One cannot have "notice" of a claim against oneself when a court has held that the claim is against *only* someone else, and has held that it is *not* against you.

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3. Respondents have never cited a reported decision from any court binding party "A" to a judgment on a claim in a prior case that was asserted against party "B" in that prior case but not allowed to be asserted against party "A" in that same prior case. Yet, each of the three lower court decisions take that unprecedented action — binding Petitioners to the decision in *Rhodes* that invalidates Rhodes' fee arrangement notwithstanding the denial of the motion to amend — albeit for different reasons.

B. Aside From The Motion To Amend, The Decisions Below Misapprehend Collateral Estoppel And Due Process Principles

The Court of Appeals' collateral estoppel reasoning rests on the dubious and unconstitutional notion that a "common interest" shared with Rhodes in the validity of his fee arrangement is sufficient to preclude Petitioners' from litigating the validity of their own fee arrangements and from discovery through trial. Magnifying the due process implications of this case is the Court of Appeals' concern with "efficiency" and "consistent judgments" in lieu of an actual trial of Respondents' claims against Petitioners. This discredited approach to due process taken by the New York courts cries out for review by this Court. As Judge Levine so forcefully noted in his dissent to the Court of Appeals' decision, *Richards v. Jefferson County*, 517 U.S. 793 (1996), and its progeny should have precluded the reasoning manifest in the majority's opinion.[4]

Neither Respondents nor any court in this case has suggested that there was any legal relationship between Rhodes and Petitioners at the time the *Rhodes* action was commenced. Rhodes and Petitioners had not been law partners for more than ten years at the time of the *Rhodes* trial. Respondents point to nothing in the record to suggest that Rhodes' was accountable to Petitioners in the conduct of his case. But for their "common interest" in the genesis of, but certainly not the final form of, the federally sanctioned fee arrangement, Rhodes and Petitioners were effectively strangers.[5] As Judge Levine recognized in his

4. Respondents artificially attempt to limit *Richards* to a "common-law kind of class action" and "matter[s] of public concern." Opp. Br. at 28. Yet, these restrictions are found nowhere in the *Richards* line of cases. *See Becherer v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 193 F.3d 415 (6th Cir. 1999); *Tice v. American Airlines, Inc.*, 162 F.3d 966 (7th Cir. 1999).

5. None of the decisions below make any findings concerning the scope of disclosures made *by Petitioners* prior to the 1983 formation of

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dissent, Petitioners "fall squarely under the factors relied on in *Richards* to find a due process violation." App. 37a. This Court should hear this case to address the failure to heed *Richards* and halt the state courts from issuing judgments that bind interested, but not adequately represented parties. That Petitioners were not "adequately" represented in the *Rhodes* action is obvious. Rhodes' counsel failed to even raise the fact that Section 10.64 permits a patent attorney cannot take an equity interest in a patent.

CONCLUSION

For these additional reasons, Petitioners respectfully submit that the Court should grant a writ of certiorari to the New York Court of Appeals to review the important issues of patent law, federalism and due process that are raised by this case.

Respectfully submitted,

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Biomedical Engineering Trust (Trust I). In fact, the only record evidence cited by the Court of Appeals concerning Petitioners disclosures was in Judge Levine's dissent — Petitioner Bain advised Respondents to consult an independent attorney prior to the formation of Trust I. *See* App. 22a-23a.